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FAIR OR FOUL: THE CHALLENGE OF NEGOTIATING, MONITORING AND ENFORCING U.S. TRADE LAWS

HEARING

BEFORE THE

OVERSIGHT OF GOVERNMENT MANAGEMENT, THE FEDERAL WORKFORCE AND THE DISTRICT OF COLUMBIA SUBCOMMITTEE

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

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TUESDAY, DECEMBER 9, 2003

U.S. SENATE,
Oversight of Government Management, the Federal
WORKFORCE AND THE DISTRICT OF COLUMBIA SUBCOMMITTEE,
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10 a.m., in room SD–342, Dirksen Senate Office Building, Hon. George V. Voinovich, Chairman of the Subcommittee, presiding.

Present: Senator Voinovich.

OPENING STATEMENT OF SENATOR VOINOVICH

Senator VOINOVICH. I apologize for the fact that there are not more Senators sitting in these chairs, but as you know, we are in session today. In fact, I am going to have to preside at 12 o'clock today, and many of the Senators just frankly are not in town at this time.

I felt it was important to have this hearing now because I am hoping that between now and when the Senate comes back on January 20 that some action can be taken on some of the concerns that I am going to raise at this hearing today, because there are a lot of people in this country that feel that we are running out of time on some of these issues, and it is having an enormous impact on the economy of my State and on the economy of Pennsylvania, Michigan, Indiana, and Illinois. I was just in Illinois yesterday, and they have the same concerns that we have in the State of Ohio.

Today's hearing will focus on the ability of our trade agencies to effectively negotiate, monitor and enforce our complex trade laws in a rapidly-shifting global trade environment. As our country adapts to the changing trade dynamics, I am interested in learning if we have handicapped our economy, especially the manufacturing sector.

On April 23, 2002, nearly 20 months ago, this Subcommittee held a hearing to examine the personnel challenges faced by the Securities and Exchange Commission and the Department of Commerce. The hearing was held, in part, in response to the General Accounting Office's 2001 High Risk Series, which stated that, "A lack of sufficient numbers of experienced staff with the right expertise limits the ability of the Department of Commerce, U.S. Trade Representative and the Department of Agriculture to monitor and enforce trade agreements."

This remains a concern of mine today. The Department of Commerce maintains a database of nearly 300 international trade agreements to which the United States is a participant, and over the past several years the roles and responsibilities of our trade agencies have increased in scope and technical complexity. Unfortunately, as GAO pointed out during the April 2000 hearing, the staffing levels at our trade agencies have not kept pace with this increased workload.

This combination raises doubts about our ability to effectively monitor our trade relations, and I am interested in learning how the Department of Commerce and the USTR have refined their human capital strategies to respond to a complex set of trade-related policies and workload capacity problems.

The importance of our hearing today is underscored by the fact that the United States has lost over 2.7 million manufacturing jobs since July 2000. In my State of Ohio we have felt these losses acutely, most recently seeing the loss of 6,300 manufacturing jobs in just October of this year. In July 2000 there were more than one million manufacturing jobs in my State. Today that number has fallen to 840,000. This is a loss of 17.6 percent of the State's manufacturing employment, a loss of more than one out of every six Ohio manufacturing jobs. These numbers represent a crisis for Ohio's economy, especially since the manufacturing sector in Ohio accounts for the second highest weekly earnings of any economic sector, and supports local community and schools with more than a billion in corporate franchise and personal property taxes.

I can tell you, our local political subdivisions are getting hammered because of the loss of these jobs and the value of the property.

In my opinion these numbers are the result of several factors, rising healthcare costs, high natural gas prices and other energy costs, out-of-control litigation, and our current trade policies, or rather, the mismanagement of our trade policies.

Manufacturing companies are distressed by our current trade priorities especially with regard to China. As I meet with business leaders throughout the State, their number one concern is the inability to compete on a level playing field with their Chinese competitors. I take these statements very seriously.

Throughout my years in public service, I have long advocated free trade provided it is fair trade. I was a strong supporter of permanent normal trade relations with China when the Senate passed the legislation in September 2000. In recent months, however, I have begun to question my vote on that issue. Although China's economic reforms and rapid economic growth have expanded U.S.-Chinese commercial relations in recent years, disputes have arisen over a wide variety of issues including China's currency pick and its failure to protect U.S. intellectual property rights.

While many of these concerns over China's trade practices were addressed in negotiations with China over its accession to the World Trade Organization (WTO), China has failed to implement many of its WTO obligations.

An issue I consistently hear about from manufacturers is the harm that China is doing to our economy by deliberately undervaluing its currency against the U.S. dollar. This makes Chinese exports less expensive and puts U.S. workers at a severe disadvantage. This is simply unfair. If the value of China's currency was allowed to float freely as the currencies of other major trading partners do, it would reflect China's enormous trade surplus and the value of China's currency would increase significantly.

In addition, I hear that manufacturers continue to experience significant intellectual property rights problems in China, and others in addition to manufacturers, especially in terms of illegal reproduction of software, retail piracy and trademark counterfeiting. It is estimated that counterfeits account for 15 to 20 percent of all products made in China, which totals about 8 percent of China's gross domestic product. It is also estimate that IPR piracy in China costs U.S. firms $1.85 billion in lost sales in 2002.

I am not surprised by these numbers though. I really am not. This has been an ongoing problem with China for some time now. The USTR cited China's failure to provide adequate protection of patents, copyrights and trade secrets back in 1991 when it threatened to impose a $1.5 billion in trade sanctions.

When I was in China on a trade mission in 1995—I brought about 18 Ohio businessmen to China, visited four cities—that again was an issue that we raised with the Chinese Government. At that time the International Intellectual Property Alliance, IIPA, an association of major U.S. copyright based industries was estimating that IPR piracy by China firms cost U.S. firms $2.3 billion in lost trade. The terms of China's WTO accession require that China immediately bring its intellectual property laws in compliance with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights, but I have not seen any evidence that China's behavior has changed a bit since then.

We need to stop standing by and watching as year after year China continues to counterfeit U.S. products, costing many Americans their jobs. I have not been encouraged, frankly, by statements from the administration that are working on these problems, and that we in Congress, I have been told, have to be patient. We have to be patient. We have to be patient. Manufacturers in the midwest, including Ohio, have run out of patience as they see family businesses dwindle to shadows of what they once were and loyal employees out on the street without a job.

As a member of the Senate Task Force on Manufacturing, I am working on a number of solutions to address these challenges. In June 2003 we introduced legislation to establish the position of Assistant Secretary of Commerce for Manufacturing within the Department of Commerce. This new post would be responsible for representing and advocating the interest of the manufacturing sector as well as developing policies to promote the expansion of manufacturing.

On Labor Day I was pleased to appear with President Bush in Richfield, Ohio when he announced his support for the creation of this new position, and I recently added language to the Omnibus Appropriation bill to fund this new position. It is my hope that this position will allow the Department to focus on the impact the slow economic recovery has had on manufacturing and our Nation's overall competitive position in the global marketplace.

I was an original cosponsor of a resolution strongly encouraging the Chinese Government to keep its commitment to move to a market-based valuation of its currency in accordance with its commitments to the trade rules and principles of the international community. The resolution passed the Senate on September 25, 2003.

I introduced legislation on October 20, 2003, entitled the Currency Harmonization Initiative Through Neutralizing Action Act of 2003, what we call the China Act. It will level the playing field on Chinese products with new tariffs in the event that the country fails to heed calls to let its currency trade freely. Specifically, it would require the Secretary of Treasury to analyze and report to Congress whether China is manipulating its currency to achieve an advantage in trade. If manipulation is found, the Secretary would be required to levy tariffs equal to the percentage of manipulation found. This would be in addition to tariffs currently in place on Chinese imports. Full membership in the community of modern nations requires China to deal fairly with its trading partners, but that is not happening, and such behavior has to end.

On November 25, Senator Snow and I introduced comprehensive legislation, the Small Manufacturers Assistance Recovery and Trade or SMART Act, to aid the Nation's troubled manufacturing sector and to help manufacturers hard hit by foreign competition and trade barriers to get back on their feet. With small business manufacturers constituting over 98 percent of our Nation's manufacturing enterprises and employing 12 million people, it is impossible to overstate the role of small manufacturers within the overall manufacturing industry and our Nation's economy.

Most recently I have been working on a resolution that would urge the USTR to initiate a 301 investigation into Chinese currency manipulation. Unfortunately, the Treasury Department objected to it. This is very frustrating to me that there appears to be no coordination between agencies on this issue. On one hand I hear Congress talking about how concerned they are with the currency manipulation issue. Yet when I talked to Secretary Evans about the issue, he tells me that he cannot talk about it because it is Treasury's responsibility. If this issue was such a big deal, if it is such a big deal, Commerce and the USTR should be pushing Treasury to get the job done. They ought to be working together.

I have to tell you if I was Governor of Ohio and I had a problem and I sent different people over to China to talk, I would make sure that if something was high on my priority list that they would be hearing comments from finance or anybody else, OMB, that you sent over there, so they get it. So you hit them with a big hammer so that they understand that something has got to be done.

I want to say one other thing. I have concerns about State and trade. I have had for a long time, as a governor and mayor. I'm concerned, for example, about North Korea and Taiwan getting in the way of strategic trade issues that impact on our economy. I hope that the President has these issues on his plate today when he talks with Wen Jiabao. As a matter of fact, they are talking today. I am hoping that he talks about the issue of currency. I hope he is talking about intellectual property rights. I hope he is talking about their compliance with the WTO, that the American people are becoming very frustrated, and some of the greatest supporters in the U.S. Senate, including this Senator, has almost had it. I am going to be watching carefully any new trade initiatives that come out of the administration in terms of whether or not they are getting the job done.

I am looking forward to learning what the U.S. Government is doing to help our ailing manufacturing sector and whether key trade agencies have the workforce needed to get the job done. For example, if we had more staff with the right skills at USTR and Commerce, would China continue to violate U.S. intellectual property rights? Is the Federal Government being proactive enough to protect American manufacturing jobs? These are important questions. They need answering. I am hopeful that today's hearing will provide some answers as well as some solutions to challenges facing manufacturers in order to help weather this crisis, and it is a crisis.

We have an impressive lineup of witnesses, and I look forward to a very informative discussion.

Our first witness today is Dr. Loren Yager, the Director of International Affairs and Trade at the U.S. General Accounting Office. Dr. Yager testified at our hearing in April 2002, and I am really looking forward on an update on what has happened.

Representing the Bush Administration are Hon. James Jochum, Assistant Secretary for Import Administration of the Department of Commerce, and Hon. Charles Freeman, III, Deputy Assistant U.S. Trade Representative.

Linda Cheatham, Chief Financial Officer and Director of Administration of the International Trade Administration and the Department of Commerce is also available. You are here to answer the tough questions. Is that it? [Laughter.]

Our second panel, we will hear from Frank Vargo, Vice President of the National Association of Manufacturers. Joining him is Dr. James J. Duesterberg, President and CEO of the Manufacturers Alliance for Productivity and Innovation. And rounding out this panel is Tim Hawk, Vice President and General Manager of Superior Metal Products and American Trim, L.L.C., a Lima, Ohio based company. His father, Leo Hawk, is sitting here in the audience with us today, and I want to thank you both for making the trip today to Washington. Thank all of you for coming, and we look forward to your testimony.

It is the custom of this Subcommittee to swear in all of our witnesses, and I would therefore ask all of our witnesses to stand and raise your right hand.

Do you swear the testimony you are about to give before the Subcommittee is the truth, the whole truth, and nothing but the truth?

Mr. YAGER. I do.

Mr. JOCHUM. I do.

Mr. FREEMAN. I do.

Mr. VARGO. I do, yes.

Mr. DUESTERBERG. I do.

Mr. HAWK. I do.

Senator VOINOVICH. Let the record note that they answered in the affirmative.

Please sit down. I would appreciate if you could please make your statements in 5 minutes or less, try to keep it at that if you can. All of the statements will be entered in the record in their entirety, and Dr. Yager, I would appreciate your starting the testimony today.

TESTIMONY OF LOREN YAGER,[1] DIRECTOR, INTERNATIONAL AFFAIRS AND TRADE, U.S. GENERAL ACCOUNTING OFFICE

Mr. YAGER. Thank you, Mr. Chairman. I am pleased to be here today to discuss the human capital challenges faced by trade agencies in the current world environment. Trade has become an increasingly important component of the U.S. economy, and therefore, the institutions and arrangements that regulate this trade have also increased in importance.

At least 17 Federal agencies are involved in developing and implementing U.S. trade policy, with a relatively few agencies, including the U.S. Trade Representative (USTR) and the Department of Commerce having lead roles in negotiating new agreements and monitoring the compliance of other nations with existing agreements.

The main point of my testimony today is that U.S. trade agencies need to more actively pursue human capital planning to successfully meet the challenges they face. In this statement I will briefly summarize some of those challenges, as well as focus on a few of the human capital practices that GAO has discussed before this Subcommittee on numerous occasions.

My observations are based on a number of studies that we have conducted on important trade developments since the last hearing that you mentioned in your opening statement. We have also updated some of these studies with recent interviews with USTR and with Department of Commerce officials. In addition, we have incorporated insights from the human capital reports and testimonies, where this Subcommittee has taken a leadership role.

Let me first talk about three key challenges that face trade agencies in the current environment, and I provide more detail on each of these challenges in my written statement.

The first is a substantial increase in importance of security since September 11 for many of the personnel who have front line trade responsibilities in U.S. border points and in other locations. In addition to their existing functions of ensuring revenue collection and compliance with other requirements, these personnel are now required to guarantee the goods destined for the United States are free from weapons of mass destruction.

The second challenge is the ambitious negotiating agenda involving active negotiations in the multilateral WTO, the regional FTAA, and numerous subregional bilateral agreements. Ambassador Zoellick has stated on numerous occasions that efforts on all three fronts are part of the competitive liberalization strategy of the United States. However, participation in these negotiations is quite demanding on the staff of USTR as well as the agencies such as the Department of Commerce, due to their key role and expertise in various aspects of the negotiations.

[1] The prepared statement of Mr. Yager appears in the Appendix on page 39.

The third challenge is the most wide ranging, and that is responding to the inevitable but unpredictable changes brought about by globalization. One aspect of this involves ensuring that existing agreements and structures are serving U.S. interests. I should note in this regard that USTR has just announced significant changes to update one of those structures, the 25-year-old Trade Advisory System. GAO reported last year that the system no longer reflected the current composition of the U.S. economy. It also means responding to major changes in the trade environment, such as the challenge brought on by China. Our prior reports and ongoing work stress the importance of actively monitoring China's commitments to the WTO, and we note in particular that Commerce's market access and compliance group has increased its staff to accomplish that goal while USTR has reorganized its Asian work to enable this function to be performed more effectively.

Everything I have said up to this point refers to the human capital challenges facing U.S. trade agencies, but of course, that is only half the equation. On the other side of the equation are the insights on the ability of these agencies to respond to these challenges. Let me make two observations based on the numerous testimonies the GAO has provided before this Subcommittee and outlined in our High Risk Series and other reports.

First, the approaches have to be tailored to meet the specific needs of the organizations. In the case of the trade agencies this means there must be close coordination between the agencies on the wide range of functions that require that coordination whether it is negotiations or monitoring and enforcement. USTR was designed and remains a small organization that relies heavily on the expertise supplied by other agencies.

Second, human capital planning should be used to ensure that the agencies are capable of achieving the strategic goals identified in their planning cycle. In addition, planning can identify and address areas where human capital practices could be made more flexible to accomplish the goals more effectively as well as to respond to the international events that inevitably occur and require the agencies to adapt their policies during the course of the year.

Mr. Chairman, I should also mention that we have just started work on two subjects that you mentioned in your opening statement. We have a request from Chairman Manzullo and Chairman Snow to look into the currency practices in China and other Asian countries, and we also have a request from Chairman Davis of the House of Representatives to look into the enforcement of U.S. intellectual property rights regulations around the world.

This concludes my testimony, Mr. Chairman. I would be happy to answer any questions that you have.

Senator VOINOVICH. Thank you very much, Dr. Yager. Mr. Jochum.

TESTIMONY OF JAMES J. JOCHUM,[1] ASSISTANT SECRETARY FOR IMPORT ADMINISTRATION, DEPARTMENT OF COMMERCE

Mr. JOCHUM. Thank you, Mr. Chairman. I know those of us in the administration appreciate your dedication to this issue, and I appreciate the opportunity to further define the administration's efforts in this regard.

For the President and Secretary Evans, the importance of trade extends well beyond the economic realm. As the President has stated, open trade is not just an economic opportunity, it is a moral imperative. When we negotiate for open markets, we are providing new hope and promoting political freedom. It is because of the economic and social imperative behind trade that the administration has moved aggressively in pursuing an ambitious free trade agenda. We will continue to move forward to expand trade and economic opportunities that it creates for all Americans and to eliminate barriers to the free flow of American goods, services, investment, and ideas.

The administration understands, however, that an aggressive trade-liberalizing agenda must be accompanied by the strict enforcement of our trade laws. We understand the value of competition and that it leads to innovation, growth and a higher standard of living. But some of our trading partners have failed to fully embrace fair competition. While we continue to encourage the opening of new markets like China, we expect our trading partners to compete on a level playing field and reduce practices that distort normal and fair trade relations.

Today's hearing offers me the chance to review some of our findings from the more than 20 roundtable discussions that the Commerce Department held with U.S. manufacturers, both large and small, across the country as part of our manufacturing initiative. In addition, I will briefly discuss the trade relationship with China in the context of other issues raised by U.S. manufacturers.

The administration understands the importance of manufacturing to the success of our overall economy, our workforce and our Nation's future. The manufacturing sector represents 14 percent of our GDP and 13 percent of total private sector employment. Manufacturing innovations at home and abroad are also important contributors for success in other sectors such as agriculture and services. Advances in John Deere's cotton-picking equipment manufactured in Des Moines, Iowa, for example, made cotton producers throughout the South and West more efficient and productive, and advances in servers produced by Cisco and Sun Micro Systems enable hospitals across the country to offer both high quality and lower cost healthcare to millions of Americans.

Having said that, there is a growing perception in the media that American manufacturers are weak, cannot compete, and are being hollowed out, and much of that stems from the significant pressure that U.S. manufacturers faced in the recent downturn of the economy and from stiff competition abroad.

It is important to remember then that even in the face of significant challenges, American firms have built the strongest, most dynamic manufacturing sector in the world. The U.S. remains far and

[1] The prepared statement of Mr. Jochum appears in the Appendix on page 69.

away the largest producer and exporter of manufacturing goods in the world, and standing alone, our manufacturing sector would rank as the world's fifth largest economy, larger than the entire economy of China. That is why manufacturing not only matters, but it is worth fighting for, and fortunately the stimulus of recent years has softened the blow from the recent downturn and set the stage for vigorous economic growth going forward.

Just to repeat the numbers we have seen lately, the third quarter of this year experienced an 8.2 percent raise in growth, the best in about 20 years, and the manufacturing index, the Institute of Supply Management, showed the highest number in 20 years. Even on the employment front there are good signs that the economy is growing. The most recent figures from the Labor Department reveal that the unemployment rate at 5.9 percent in November has trended down and the economy has created 328,000 new jobs in the past 4 months.

This positive news, however, does not negate the fact that you mentioned, Mr. Chairman, that the manufacturing sector has lost more than 2 million jobs during the recent downturn. In short, our manufacturers continue to face a highly global competitive environment and we need to foster an environment in which our firms can compete and succeed in manufacturing.

In March of this year, during Manufacturing Week, Secretary Evans announced the President's Manufacturing Initiative, and this announcement was followed up by roundtable discussions in more than 20 cities across the United States to gather input for a report on the state of manufacturing and recommendations for policy reforms.

While international competition is what has garnered most of the attention in the press, by far the greater weight of the manufacturers' comments focused on domestic issues. We heard that while U.S. manufacturers have tightened their belts and raised their productivity, those productivity gains have been eroded by everything from higher energy costs to higher medical and pension costs, to higher insurance costs due to a runaway tort system. For example, we heard from manufacturers in New Jersey that 30 cents of every dollar of revenue went to pay health benefits for their employees, which was an increase of well over 100 percent in just a few years. We heard about asbestos litigation and other lawsuits that hang over the heads of virtually all U.S. manufacturers, raising their insurance costs and dampening their returns. The manufacturers also pointed to declining vocational school programs, declining enrollments in engineering and the funding of scientific research, all of which are essential to the productivity gains that keep our manufacturing sector competitive.

In addition to keeping our own side of the street clean, manufacturers demanded a level playing field internationally, and what that means in practical terms is three things. The first is exchange rates that reflect economic fundamentals of the market and not government intervention. The second is an effort to eliminate tariff and non-tariff barriers to our exports through negotiations with our trading partners. And the third is the vigorous enforcement of both the existing international trade rules and U.S. trade law. The goal is simply to ensure that everyone on the field is subject to the same rules of the game.

What we did not hear from the vast majority of manufacturers that we met with was an interest in outright trade protection. Rather, our manufacturers see international trade as a simple question of fairness. If we keep our markets open to our trading partners' goods, they should do the same for us.

While we are still in the process of finalizing this report and its recommendations, Secretary Evans has taken steps in response to the concerns we heard, particularly the need for a stronger focus within the U.S. Government on manufacturing. The first initiative, announced by the President on Labor Day, is a new Assistant Secretary of Commerce to serve as the point person in the administration for manufacturing. The second is the establishment of an Unfair Trade Practices Team to track, detect and confront unfair competition before it injures an industry here at home. And the third calls for the creation of an Assistant Secretary for Trade Promotion, to boost our exports, particularly to those markets that our negotiators have recently opened to trade.

During these roundtable discussions, there was no single topic that garnered more attention than our trading relationship with China. We all know the stakes are very high. Our bilateral merchandise trade with China reached the level of $147 billion last year, and within that year China overtook both Japan and Mexico to become our second largest source of imports. Many have noted that our imports from China are more than five times greater than our exports, and our bilateral trade deficit exceeded $100 billion in 2002. There is also an obvious upside to China's growth. The rising standard of living in China has created consumer demand for U.S. products that did not previously exist. What that means in trade terms is that China today represents the fastest-growing market for U.S. goods and services. Our exports to China surged by 19 percent in 2001, 15 percent last year, and about 18 percent in the first 8 months of this year.

The Commerce Department, in close coordination with the USTR and other agencies, had adopted a multi-pronged approach to ensure that China honors its WTO commitments. We will continue to target unfair trade practices wherever they occur, but enforcing our trade laws is only part of the solution. We must continue to enhance the ability of U.S. businesses to compete in China. For example, we are launching "Doing Business in China" seminars in cities across the country to address concerns about the Chinese market from small- and medium-size businesses. At the Commerce Department, the International Trade Administration, or ITA, is charged with carrying out these activities. ITA's mission is to create economic opportunity for U.S. workers and firms by promoting international trade. It has been more than 20 years since ITA reorganized itself to ensure that we are fulfilling this mission.

In 2002, while we were conducting our national export strategy, we went out to our customers and surveyed them on our work, and as a result we will focus and redeploy our resources where our clients tell us they need it most.

Although the details of this ITA reorganization are still being finalized, plans include replacing the existing Trade Development

Unit with the Assistant Secretary for Manufacturing, consolidating all trade promotion activities within the commercial service, and streamlining trade law administration and allocating additional resources to China.

As I said earlier, the new Assistant Secretary for Manufacturing will focus on both domestic and international aspects of U.S. industrial competitiveness, and will work closely with a new interdepartmental committee that will be created to focus and coordinate all of our Department's expertise on the problems of the manufacturing sector.

The second step in the reorganization will consolidate all trade promotion services within the commercial service. This initiative will allow us to link our advocacy efforts more directly to the domestic and overseas networks to enable early project support, as well as post-transaction assistance. And, as someone who has done trade advocacy, this is really what other countries have done for many years, and what we have failed to do.

The third step in the reorganization is streamlining our trade law administration and allocating additional resources to investigate unfair trade activities within China, and this function falls within my agency, the Import Administration. We are creating a new office devoted exclusively to China, which is the object of a disproportionate number of trade complaints.

And by way of background, during the last 3 years, we have initiated more anti-dumping investigations and placed more anti-dumping orders against China than against any other country, and more than twice as many as we have against the next leading country. In 2003 alone, more than 50 percent of all of our new anti-dumping orders put in place have been against China. Historically that number has been about 15 percent.

As I noted earlier, we are also creating an Unfair Trade Practice Team that will try to look at trade coming in before it causes a problem. Our goal here is to preempt things and allow us to follow up with all the tools we have at our disposal.

In conclusion, I want to stress that the administration has heard the concerns of U.S. manufacturers and certainly the concerns of this Subcommittee, and we are committed to ensuring a level playing field when competing in today's global marketplace. The Commerce Department is developing a strategy to ensure that government is fostering an environment that promotes a dynamic manufacturing sector. Part of that plan is the reorganization of ITA that will allow us to better respond to unique problems of U.S. manufacturers.

Thank you again for inviting me to testify today, and I look forward to your questions.

Senator VOINOVICH. Thank you very much. I am impressed with some of the statistics that you have shared with us. Mr. Freeman.

TESTIMONY OF CHARLES W. FREEMAN, III,[1] DEPUTY ASSISTANT U.S. TRADE REPRESENTATIVE

Mr. FREEMAN. Thank you, Mr. Chairman. It is an honor and a privilege for me to testify here today on behalf of USTR. I am specifically here to testify a little bit about some of the human capital challenges that we face at USTR with respect to monitoring and enforcing China's WTO commitments in particular.

As most of you know, Thursday, December 11, is the second anniversary of China's WTO accession, and in the process of leading up to that accession on December 11, 2001, there was 15 years of negotiations which structured a very comprehensive, rather unique agreement with thousands of requirements for China to implement relatively immediately. And the good news is that they implemented quite a few of them on time. The bad news is that they have not implemented all of the things that we were hoping they would. But let me tell you a little bit about USTR and how we are focused on the China issue.

Initially, USTR is deliberately a small organization. It is small, it is nimble, it is designed to be agile, it is the original networked organization in government if you will. We work very closely with Commerce and with other agencies in the U.S. Government. We draw extensively on expertise in other agencies, as well as internally.

I have to say that the quality of the personnel at USTR is among the highest in government, in my view, although my colleagues may disagree somewhat, but really the level of skill there is first rate, the level of experience is first rate there. USTR is still considered a place that people in government want to go because the quality of the work and the quality of the personnel is so high.

We are very small, even within the China shop, I think there are four of us that are dedicated full time to working on China, but within the USTR there are 200 employees totally. We work with probably 45 additional people, whether it is in the General Counsel's Office or with respect to the other sectoral offices, industry services, intellectual property rights and a variety of issues.

I have to say that Ambassador Zoellick and his deputies spend a disproportionate amount of time on China, especially given the high demands places on their time by negotiating the FTAs, negotiating the Doha agenda and living up to a very ambitious trade agenda that the President has set. So China gets its fair share of our time.

USTR is the chair of the WTO TPSC Subcommittee on China's WTO compliance. There are 14 different agencies that take part, 14 different agencies and departments, about 40 professionals, and that's really the primary means that we use to coordinate policy with respect to China's WTO implementation. We meet perhaps once a month, but there's active discussions among the various members thereof, and they draw on their own agencies to bring them into the process.

It has been an increasingly successful way to make sure that we are hearing the same things from industry, that we are saying the

[1] The prepared statement of Mr. Freeman appears in the Appendix on page 84.

same things to the Chinese, and that our priorities, with respect to China's WTO compliance issues, are in order.

Roughly speaking, we have five different areas on which we are focused with respect to China. The first is obviously WTO implementation. China has had, as I said, to make thousands of reforms as part of its WTO implementation so it has been our job to look and make sure that they are in compliance with the nuts and bolts of WTO implementation. I will say that nuts and bolts they may have been in compliance with, but there are a variety of things where we have been relatively disappointed with respect to their implementation.

Closely related to the WTO implementation is ensuring that we have fair market access to China. Our primary means of looking at issues with respect to the deficits and with respect to making sure that the trade balance is fair is making sure that the Chinese understand that, unless we have fair access to their markets, we cannot maintain the support, as you know, for maintaining open markets to China.

The other issues on which we are working are transparency standards and regulations. It is a key WTO implementation commitment, and China was supposed to make sure that not only were the processes by which they publish new regulations transparent, but also that a variety of public, that the public, in general, including our industry, was given appropriate means to comment on regulations as they came out.

Other issues on which we are focused are better cooperation with China and the WTO, making sure that the Chinese are on the same page with us, in terms of overall liberalization efforts, and finally we are very focused, last, but not least, on ensuring China's compliance with our efforts to enforce U.S. trade remedies.

I am happy to answer any questions with respect to any of these issues.

Senator VOINOVICH. Thanks very much.

Mr. Yager, in your agency, cooperation is necessary for developing U.S. positions to address trade compliance issues. Mr. Freeman, I think you said you are coordinating, how many, 17?

Mr. FREEMAN. Fourteen.

Senator VOINOVICH. Fourteen different agencies in trying to deal with all of the various issues that come up with trade. What specifically do you think our trade agencies must do to improve cross-agency communication, coordination and cooperation? And the one I just mentioned was the whole issue of this issue of currency manipulation. It seems like there is only one agency that can talk about it, and the rest of them are prohibited from even mentioning the subject, and I would be interested in your observations regarding that policy.

And the last, of course, is the thing that got me into this in the first place: Do you think that our trade agencies have the human capital capacity to move forward? In other words, we have heard some really wonderful things from Mr. Jochum, for example, about what the agency is about to do or is doing, but the real issue is do they have the right people, with the right skills and knowledge, at the right place, at the right time to get the job done? That is the real challenge.

Dr. Yager, I would like to have your candid observation. In your testimony, you say “Our work shows that these forces have stretched the human capital resources of the U.S. trade agencies. Although the government has taken steps to address some of these challenges, these, and other, changes in the global trade environment require that the trade agencies constantly monitor and update their human capital strategies to ensure that they are closely linked to the strategic goals of the agencies.” That is easier said than done.

“The number of fully authorized full-time staff at USTR, Commerce Import Administration, the Commerce Market Access and Compliance Division has increased in recent years. However, actual staff levels are still in the process of catching up with authorized levels in Commerce and USTR offices, and USTR has requested additional staff resources for 2004.” And I am really pleased that you are doing that, Mr. Freeman.

And then you have gone on in your testimony, Mr. Yager, and you say, “In recent years, the U.S. has been pursuing a broad trade policy agenda whose cumulative impact has tested the limits of the government’s negotiating capacity.” I mean, we are just really involved right now in a lot of stuff that perhaps we have not been involved with as aggressively in the past and perhaps in other administrations. I am not here saying that we should not be doing it, but the agenda includes undertaking negotiating efforts in multilateral regional and bilateral arenas. I am surprised Mr. Zoellick gets any sleep. [Laughter.]

The administration has characterized this effort as the strategy of competitive liberalization. The United States was actively involved in the challenging WTO round of negotiations at Doha, Qatar, in 2001;

Second, the United States is also co-chair in ongoing negotiations to create the Free Trade Area of the Americas, which was something that people in South America complained about when I visited them in 1998, that we were not moving forward with it;

And, finally, with the passage of the Trade Promotion Authority in 2002, the United States has launched a series of bilateral and subregional Free Trade Agreement negotiations. The increase in the number of these negotiations at the same time that major global and regional trade initiatives are underway has strained available resources.

In other words, the question is do we have too much on our plate to handle, to do a good job with the job that needs to get done?

Mr. YAGER. Well, that is a good question, Mr. Chairman. I think the one point that you made, which is certainly valid, is that since Trade Promotion Authority passed the Congress, there has been a very sharp increase in the amount of activity that is going on. Of course, we have long been involved in the multilateral negotiations as part of the WTO, and the FTAA process has also been ongoing for some time. But where there has been a rapid increase in activity is with the bilateral and subregional agreements that are currently being negotiated by USTR with the assistance of Commerce and other agencies.

And so, at the current time, we are negotiating with the Central Americans. We are also negotiating with Australia and other countries. And as soon as those agreements are completed, there are other countries that are waiting to start negotiations. For example, we are due to start with the Dominican Republic, to add that to the CAFTA, and then there are a number of countries in the Andean region that are also waiting to begin negotiations.

So there is no question that there is a lot of activity, particularly in these bilateral-type agreements, and that is something that has certainly increased in importance in the last couple of years.

One of the things we thought that made it particularly important is that USTR, given the fact that it does rely so heavily on expertise from other agencies, such as Commerce, Agriculture and others, needs to look at these kinds of negotiations as part of its planning process and discuss more actively the kinds of personnel they will need, the kinds of assistance they will need, and frankly the kinds of budgets that those support agencies will also have to put in place to enable them to do the travel, to do the negotiations and to have the kind of people involved that are required in order to make sure that these agreements actually serve the U.S. interests.

And so we think that, given again the small size of USTR, as Mr. Freeman noted, it really makes it imperative that they work this into their planning process and coordinate very closely with the other agencies because they do depend upon those other agencies in order to supply the kinds of expertise that they need.

Senator VOINOVICH. Yes, but based on the expanded area of responsibility within our trade agencies, do you think they are organized properly? In other words, if they have to rely on several other agencies in order to get the job done, those agencies themselves, in terms of management, are having difficulty just trying to look at whether or not they have got the people that they need to get the job done.

Then, you have to coordinate with another agency to make sure that you have the people so they can get their job done. Would it be better off if some of these areas were organized differently. For example, the USTR relies heavily on the use of detailees, do you think this is an effective human capital strategy?

Mr. YAGER. Let me answer two ways or provide two parts to an answer on that one.

The first is that there is a process by which certain officials from Department of State, Agriculture and Commerce are actually loaned to USTR at various points in time in the form of detailees. When they do need that kind of expertise on a longer term basis, there are a number of detailees that are placed in USTR for a period of years.

Senator VOINOVICH. The question is have you reached the stage where the detailees should be permanently located in the USTR and be responsible to their chain of command?

Mr. YAGER. That is a good question, Mr. Chairman. I think what is very important though is that it is clear to those people at the beginning of their employment at Commerce or other locations that they are in, and an important part of their duty is to serve with USTR as part of the negotiating team. And I think that is again one of the reasons why we think it has to be addressed early. It has to be made clear to those people, in their performance requirements, that part of this is to assist in negotiations.

Obviously, these are smart people that are working at Commerce and the other agencies, and they are responding to the kind of performance incentives and the end-of-year feedback that they get. It needs to be clear that what they are there to do is to help serve with USTR and to move forward in those negotiations.

Senator VOINOVICH. I hate to nitpick with you, but even in performance evaluation, if I am working in one agency and I am on loan to another agency, who does my performance evaluation? Is it my agency or is it in the other agency? When people are hired, do they know at the Department of Commerce that they are going to be on loan, for example, to the USTR?

Mr. YAGER. I think the other part of that answer that I wanted to mention was the fact that it is inevitable that USTR, whether it becomes larger, will still require the expertise from some of these other agencies. There is certainly no way that one agency will ever have the expertise on the wide range of topics that are currently contained in a trade agreement, whether these are safety or health or at certain times the business relationships or expertise that are required. So it is inevitable that they will rely on other agencies.

Now, whether they could have more personnel within USTR to handle some of those functions, that is a question, but, inevitably, other agencies, as I mentioned in my statement, there are about 17 agencies that do participate in trade policy, and some of that has to do with the complexity of trade policies and the types of agreements that are currently an issue.

Senator VOINOVICH. Do you think it would be wise if somebody examined that situation to make a determination as to whether or not perhaps they ought to have more people on board that have the expertise that they are now getting from other agencies? Do you think it might be worthwhile to look at that with——

Mr. YAGER. That certainly is a question that we could look into, Mr. Chairman, if you want to go forward with that.

Senator VOINOVICH. I think I would. I think it is important that we look at that issue.

First of all, I would like to say, Commissioner Jochum, I was impressed with some of the statistics that you shared with us this morning, and I agree with you. I have said in many instances, and you have had 20 hearings, and I have had at least four hearings in Ohio. In fact, I recently had a hearing in my office with four Ohio manufacturers, and Secretary Evans. He was kind enough to come and spend over an hour with us. I think it is important that we make clear today that even if we solve the issue of the manipulation of currency by the Chinese or their violating intellectual property rights or not complying with other requirements of the WTO that our manufacturers in this country continue to have some significant problems.

For example, if we could do something about the cost of natural gas, it would have enormous impact on manufacturers. In my State, mutual gas costs have doubled. Unfortunately, we are not producing enough natural gas to keep up with the demand. Furthermore, some environmental concerns are exacerbating the demand for natural gas—which is another reason why we should pass the energy bill.

The other issue is litigation. It is not on the table, and it is not being talked about, but litigation is a tornado that is ripping through the economy of America. And, again, we have legislation in Congress to deal with asbestos reform and malpractice lawsuit reform. Each impacts the cost of healthcare in this country, and costs associated with class action lawsuits. In fact, I asked the American Tort Reform Association to do a study to investigate the cost of class action lawsuits in Ohio.

Litigation is costing every Ohioan $650 a year. So it is another fact we need to address, instead of just saying, well, if we just take care of China everything will be OK. The fact of the matter is we could take care of China, and we are still going to have some significant problems.

And then of course you have to deal with the healthcare issue, and that is a tough one. Again, we may be hearing from some of the other witnesses, but in our State it costs about $10,000 for a business to take care of family healthcare protection for an individual. They are competing in the global marketplace, say, with China, where those healthcare costs are not reflected in the cost of their product. We are now in a global marketplace, and the real issue is are we organized in a way to compete in that global marketplace in terms of the costs that are incurred by our businesses.

So I think it is important that we make that a point so that people understand that we must have a full-court press on lots of issues and not just concentrate on one and think that it is the silver bullet that is going to take care of dealing with all our problems.

I would like to ask you, Mr. Jochum, what is the status of the reorganization that you talked about? Now, I was pleased the President announced that Secretary Evans went up to Detroit to the Economic Club and explained what he was going to do. I talked informally with the Secretary. I wondered whether or not you were going to get somebody in-house to do the job. At that time, I suggested maybe it would be good because it takes new people a while to learn the organizational structure. However, it seems like you moved away from hiring someone from the inside. I understand you are now having interviews for someone that would head up the new position.

I just want to tell you that we have to get going. I do not know, is this new person going to require confirmations by the Senate, for example? I see somebody nodding their head.

Mr. JOCHUM. I would assume so.

Senator VOINOVICH. And you know what that is around here. It is not easy.

It seems to me that by the time we come back in January, you guys ought to have whoever it is that you want in place and come in here and talk about it and let us get going because we are running out of time.

How are you doing?

Mr. JOCHUM. As someone who went through confirmations twice in the last 3 years in the Senate, I can tell you it is not only an enjoyable experience, but you stretch it out over many months so you can really enjoy it. [Laughter.]

My understanding on the reorg, Mr. Chairman, is that the parts I believe that you have noted today are all within the omnibus appropriations bill, and that if that bill were to pass the Senate this week—and I know that is uncertain, although it did pass the House yesterday—we would be poised to move forward.

My understanding is that the personnel decision regarding who that individual may be is working its way through White House personnel, but they are fairly close and ready to announce someone if we had the authority to do so. So that is my understanding of the elements that we mentioned today.

There are other parts of the reorg that I mentioned that we can do now. For instance, the Unfair Trade Practices Team within my agency is part of the omnibus bill, but I think that is something we can do without additional funding, and so we are putting measures in place to get that up and running immediately, and have actually started carrying out some of the functions of that team. But passage of the omnibus bill would be a great help in moving our reorganization forward.

Senator VOINOVICH. In the process of putting that whole organization together, is the U.S. Trade Representative aware of what you are doing and are they in tune with what you are doing and some of the other 14 agencies we discussed.

Mr. JOCHUM. Yes.

Senator VOINOVICH [continuing]. So that they have an idea of where you are going?

But the thought that I had which is why I introduced the legislation—would be that you have to have an orchestra leader. You are dealing with lots of agencies, and you have got to have somebody that gets up early in the morning and goes to bed late at night trying to make sure that they are doing their job, but also making sure that they are dealing with other sections of the orchestra that may be in other departments.

Mr. JOCHUM. No, that is exactly right. And I think the way it was structured, maybe in the bill and maybe in your bill, was that they would report to the President. So they would actually be, technically reporting to the President. So they would have the ability to orchestrate, if you will, or deal with other agencies at that level. Notwithstanding some of the comments on coordination with USTR that we have heard today, I think we have a tremendously high level of coordination with USTR, both on a formal basis, through interagency committees—Mr. Freeman heads some of those up—but even all the way up to deputies and principals meetings, but also at an informal level, at my level and at the working level—a tremendous amount of coordination. So they absolutely do know all of the initiatives we are putting in place.

I often bounce ideas off people at USTR to get their thoughs on new initiatives such as the Unfair Trade Practice Team. So I think it really is a coordinated government effort. It just happens to be housed in the Department of Commerce.

Senator VOINOVICH. We made some government-wide human capital modifications in Title 5 U.S.C. with the Homeland Security legislation. Has that helped at all in terms of meeting your recruiting and retention challenges? In other words, do we need to do more in that area? According to the statistics, you are authorized for “X” number of people, and you do not have those people on board. Where are we with that? Are you having a hard time finding people? Is the salary level not competitive? Are you still using the rule in three or have you gone to the new flexibility of category ranking.

Mr. JOCHUM. Ms. Cheatham may be able to go into greater detail, but my understanding is that there has always been a gap between authorized FTE levels and the funding needed to hire those people.

To put it in context, I ran a different agency before I came over here, at the beginning of the administration, and hiring is one of the greatest challenges we face. One perverse effect of the downturn in the economy in 2001–2002 is that, frankly, we did get a lot of good people who came into the government, into the Federal service, and I was really pleased with some of the quality individuals that we had.

In my agency particularly, we use a lot of lawyers, economists, and accountants—people who really could make more money in the private sector, for a number of reasons—but notwithstanding the recent growth in the economy, we had a tremendous influx of talent. That is not to say we always have the right mix of people.

And the point you made about matching our priorities with the experience and expertise that we need is really illustrated in this China office that is about to be created. This proposal, which is in the omnibus bill, would require us to really develop further expertise on China as a market, specifically. Right now we do not do a good enough job within the Commerce Department of coordinating all of the activities on China in one place. And my hope is that with additional funding levels and FTE authorization, we can get people into the Department who have a background and expertise on China, in particular, people like Charles Freeman and others that we already have. We need them in one place to look at this issue from a holistic standpoint.

We do our best to attract these individuals. We use recruitment bonuses. We sell the fact that you have flex time and compressed time in the Federal Government, all of those sort of lifestyle issues, to try to entice people from the private sector to us.

I was surprised. I looked at my numbers today, and a third of my workforce has been at Commerce for more than 10 years, I think. That is encouraging. At the lower level of the spectrum, you do have a high level of turnover.

As Charles said, I believe my agency is well staffed with, frankly, some of the best trade lawyers I have ever met. We could match up with a lot of mid-size law firms in Washington I would think. But there is always more we can do to entice people to come into the Federal bureaucracy because there are limits in terms of income and other factors.

Senator VOINOVICH. Well, the administration has given high priority to human capital, and we tried to create an environment in Congress to help them. And I think that when you come in with the nominee for that new office, we would like to have more information about what is happening in terms of bringing people on board and do you have the folks that you need to get the job done, and if there are some things that we can do to help you get it done, we will try and help out. The human capital provisions in homeland security were the most significant Civil Service reforms since 1978, but there is always more we can do to help.

And by the way, another issue is what role Congress should be playing in all of this? I am meddling in your business right now. I was a former governor, a former mayor, and I did not like the legislature to be mixing in sometimes on things that I thought were in my bailiwick, but as you can tell, I am very concerned about what is going on here. And the issue is what role should we be playing? How can we help you get the job done?

And you also have to understand that there is an enormous amount of frustration right now among many of us about what is going on. It is like we want something done, and the reason is because, when we go back home, our people say we need help now, not next year or 2 years from now, we need it now, and what are you doing?

What can we be doing more to help out?

Mr. JOCHUM. I think on the workforce issues, Mr. Chairman, you are one person who is already doing more to help out. From a manager's standpoint, we need flexibility to respond to new issues, emerging issues, and to be able to get the right people with the right expertise and experience to respond to those issues quickly. I think the Federal workforce moves rather slowly at this point. We need tools to recruit people and to retain people.

We talked a lot about recruiting, but retention is just as significant. We have grade levels that are capped out at mid levels and lower levels, so people do not see an opportunity to advance. I am no expert on the civil service, but I will take this as an offer to come and talk with you when we have these initiatives in place, with Ms. Cheatham at my side, and determine what you could best do to give us the flexibility to get the right people.

Senator VOINOVICH. Well, we are trying to deal with the safety cap. We have increased the cap. I know, with the Senior Executive Service, that we have had 75 percent of them making the same amount of money, and it has not helped the agencies because it demoralizes those that are really producers.

Mr. JOCHUM. That is right.

Senator VOINOVICH. And we are trying to take care of that problem too.

What I would really like to know, from somebody on the street, is what we have done is helpful, and if it is not, what else can we do to help you get the job done?

Mr. JOCHUM. I appreciate it.

Senator VOINOVICH. The other thing I would like to find out from you is, as a governor, I took 10 trade missions overseas. In some countries, the Foreign Commercial Service Office was outstanding. We dealt with it. Others, we concluded that it did not get the job done and went to the private sector. In some cases, we had ambassadors that really seemed to get it in terms of economic development and trade. Others did not seem to get it.

When I was in Bratislava, I became impressed with Ambassador Weisser, a former resident of Michigan, because he was out hustling joint ventures and so forth.

What is the status of our former commercial folks around the world?

Mr. JOCHUM. Maybe Ms. Cheatham can discuss what we have been doing in that regard, but one thing the reorg will do is to match our trade promotion activities with our Foreign Commercial Service officers, because two different entities are doing those activities now, which I think really puts us behind where other countries are. In my latest job in the administration, I did a lot of advocacy on behalf of defense contractors around the world, and I just think you need to link those two functions up.

I do know that we have more than 1,000 people in the Foreign Commercial Service, and I have used them when I have traveled, both in the private sector and in the administration, and I have found them to be extremely helpful. I have also noted, and I met with a lot of ambassadors—I was in Brataslava 2 years ago—that I believe Secretary Powell has really instilled a culture in the Foreign Service that appreciates the economic aspect of the equation. So I think very positive changes have been made in that regard.

If you want some current sort of details on where the Foreign Commercial Service will go in terms of the reorg, maybe Ms. Cheatham can speak to some of that.

Ms. CHEATHAM. One of the things that we are trying to do, Mr. Chairman, is to consolidate all of the promotion activities in the Foreign Commercial Service so that when companies are doing business overseas, there is one point of contact that they have to deal with. The advocacy center will also help here.

As Mr. Jochum said, there are approximately 1,100 people that we have stationed overseas in about 85 countries.

Senator VOINOVICH. It is important to help our businesses do business in some of those countries. Your job is vital because without your help, it just doesn't happen. I had some wonderful experiences and I had some not-so-wonderful experiences.

Secretary Evans was in Beijing on October 28, and he stated that U.S. patience on China's WTO compliance was, "wearing thin," and warned of, "growing protectionist sentiments in the United States against China." This growing anger towards China's IPR policy coupled with China's rigid adherence to a pegged currency policy has created an environment that is conducive to Congressional intervention.

It gets back to the same question I asked before, which is what role should Congress have in regard to fair trade with China and our international partners? I have introduced legislation and Congressman Phil English has introduced legislation in the House to establish an Assistant Secretary of Manufacturing at Commerce. Can you explain who is responsible for the enforcement? Do you work with the U.S. Trade Representative? Is that strictly their responsibility, Mr. Freeman?

Mr. FREEMAN. The enforcement of trade?

Senator VOINOVICH. Yes.

Mr. FREEMAN. Generally, we work very closely with Commerce on all these issues. It really depends on what the issue is to see who has the lead.

With respect to intellectual property rights issues in China, I know we have a very strong team that we have worked together with in China that deals with it, and also with respect to currency. One of the things that, as you mentioned, Secretary Evans when he was in China was very strong on the currency issue was focused on that. I know Ambassador Zoellick, when he was there earlier in the month, had also spoken on it, and Secretary Snow back in September. So there has been a very unified message that the Chinese have heard on the currency front.

The sense of the administration is that they have the message and that they are moving forward. It may not be on the timetable that a lot of us would like to see, but certainly in terms of making progress, they are pushing in the right direction.

Senator VOINOVICH. When I talked about the reorganization, I was talking about having somebody get up early in the morning and stay in late at night making sure that we enforced our trade laws. Fundamentally, the concern is this, is that if I am dealing with the United States and I am getting away with things and I can get on the field and run without a flag being thrown and I almost get to the goal line, I am going to run on you and run on you.

Where are we in terms of that agency, and is it in your shop where you have people that get up early and stay late at night and get the word out there that as soon as you get on the field and you break the law, we are throwing the flag and we are on you?

Mr. JOCHUM. Yes. I guess I would divide enforcement into two areas. One is the trade laws, in terms of imports and their effect on U.S. businesses. We enforce the dumping laws, and the countervailing duty laws. The dumping cases against China that I mentioned in my testimony, where we brought the textile safeguards that were announced a couple of weeks ago, all of that occurred with interagency knowledge and coordination.

Responsibility for monitoring compliance with a trade agreement as opposed to U.S. trade law, however, is really split among the agencies. We have a Trade Compliance Center within the Department of Commerce made up of 18 individuals who look at trade agreements and whether they are being complied with. We have a China office now—a little different than the one that is going to be created—which looks just at China's commitments to the WTO and within other trade agreements. That office, again, is a dozen or 16 people working with U.S. industry to identify where the Chinese have failed to meet their commitments, and then working with Charles Freeman and USTR and other agencies to develop a coordinated strategy to address those situations.

This calls to mind a similar line of questioning you had with Dr. Yager regarding who looks at these issues. When I was in the private sector doing international business for a consulting firm, we were always aware of trade barriers, probably before the government was, because we were there trying to have a transaction take place, or trying to enter a certain market. Certainly, we relied on the Foreign Commercial Service officers in those countries.

But I think a large part of monitoring trade agreements is close coordination with the private sector and with the government, and a lot of that occurs at the Department of Commerce because we have those relationships built up over many years—not that USTR doesn't, but we do that on a day-by-day basis.

So if you are talking about trade laws, we certainly enforce them. I get up every day worrying about this stuff. If you are talking about trade agreements, it is more split and I think USTR probably has the lead in going after IPR issues and things like that.

Senator VOINOVICH. The problem is that it doesn't seem that we are making progress. I have a memorandum, and I am going to ask that it be submitted in the record, in terms of the IPR and how long we have been working on IPR. Every year, we talk to China. Every year, they say it is going to get better. And I have to tell you something. You need a sledgehammer to make things better.

[The information of Senator Voinovich follows:]

MISSING ? ? ? ?

I will never forget my 97 trip to South Korea. I am asked by the big three auto companies to raise the issue of the export into South Korea of non-Korean vehicles, and I spent 3 days talking to everybody and they said, oh, we have done wonderful. They have gone from one-tenth of one percent to two-tenths of one percent. They gave me a response that if they had given that here in the United States, we would have laughed them out of the office. They wouldn't have ever tendered that kind of response to a question from me, and they did it with a straight face.

And today, South Korea exported more vehicles into the United States in one day than all of the other countries export into South Korea in 1 year. Do you get it? In other words, one day in the United States is more than the entire export into South Korea, and I am not just talking about the United States, I am talking about everybody.

When people hear things like that, they have to start to ask themselves, are we enforcing the trade laws? This is fair trade? And I think that some of these issues that are out there, you have got to break the logjam. You have to show you have made some progress. That is the frustration out there. It seems like we are talking a good game, but we are not making progress, and when you do score a touchdown, when you do get something done, you ought to let us know about it.

Mr. JOCHUM. I agree, and the last part of what we were discussing—some of the numbers I gave you in my testimony about our dumping cases are probably not widely known, although we put them on our website and otherewise make the information available. But I think we need to do a better job of communicating with Congress on the activities that we do do on a day-to-day basis.

And Mr. Chairman, getting back to your question about what Congress can do, I have negotiated with the Chinese for several years now, not on this issue but others, and they really do pay attention to what Congress is doing. It is a significant part of their calculation in terms of negotiating with us. So resolutions and bills that are introduced, I think, have a tremendous effect and allow us to have a stronger hand when we go talk to them about these issues.

Senator VOINOVICH. I sure would have liked the Treasury Department to—I worked with Dick Lugar's staff to come up with what I thought to be a very fair objective, and then we get the word Treasury doesn't want it. Why, I am asked, and that is a question I am going to ask Secretary Snow.

The last thing, Assistant Secretary, is that some U.S. companies question the Department of Commerce's ability to deal with fraudulent data, i.e., there is a problem that arises and you start dealing with people over there and they provide evidence to you and some of our people feel that it is fate. What is your capacity to pierce the veil and really find out whether or not they are giving you the right information?

Mr. JOCHUM. This comes up in the context of our undertaking a dumping investigation, primarily against Chinese companies, although we face fraud in other parts of the world, as well. Our statutory authority allows us, when we find fraud, to go ahead and apply what we call "adverse facts available," the result being that they would get a much higher dumping margin.

To give you an example, we did a review within the last couple of weeks. We found fraud. We gave them the highest duty that we could give them within the case, and so it ended up that they had a 300 percent tariff coming into the United States. That is the recourse we have under the statute. We don't have enforcement authority beyond that.

What we do is work with Customs, because those would be potential infractions of reporting laws to Customs, to give Customs the information we have seen, and have Customs undertake their enforcement authority to pursue those cases. And we have referred about 20 cases to Customs within the last couple of years. So when we find fraud, we work within the context of our case and assess a penalty, and then we refer it to Customs for them to follow up on the matter.

But this is a situation that is arising more frequently, and there are a couple of other options that we are considering right now. I would be glad to come back when we are ready to be more public about what other avenues we may explore in that regard and discuss these matters further with you.

Senator VOINOVICH. Thank you. Mr. Freeman, when is the International Trade going to go forward with a 301 on China in terms of their currency manipulation?

Mr. FREEMAN. Well, there are no plans to self-initiate at this time. Obviously, if a 301 is brought, we would evaluate it based on the legal theory. We haven't seen a legal theory yet for Section 301 on the currency. So right now, we remain interested and will look for it when it comes.

Senator VOINOVICH. Well, there are many of us that feel that you should move forward with it and that there is enough evidence that we should have a 301. I know that the President recently disbanded the 201 on steel and I was very much involved in encouraging him to go forward with that and he made a decision. But I have to tell you something. If that 201 had not gone forward, we would not have a steel industry today in this country, particularly when we are talking about slab steel and so forth.

President Clinton could have undertaken that at any time and chose not to do it, and then as a result of that, Congress introduced several quota bills that really violated the WTO straight out. It seems to me that Mr. Zoelick ought to be looking at that issue because many of us are very concerned about it. It is one legitimate way that you can raise the issue. That is under the 201—wasn't something somebody pulled out of a bag. It was available under WTO. It was available under NAFTA. It was under GATT. It was the surge provisions. You could do it.

So I strongly urge you to talk to your folks and look at this, because we are concerned about what is going on and we expect these people to cease and desist, and if they don't, then I think we have really got to go forward. And if you don't move forward with it, you are going to get some stuff coming out of this place that you may not like, that you may not like.

Last but not least, I want to ask the question about the personnel. You heard the questions with Mr. Yager, the question about whether you are organized and do you have to rely too much on other agencies to get the expertise that you need. What do you think about that?

Mr. FREEMAN. Well, we obviously feel that we could work within the President's budget that he submitted. We do note that there was some additional money set aside in the omnibus and we are certainly gratified for that.

The core of our business really is personnel and travel. Our travel budgets do get crunched now and then, especially given certain additional costs that are associated with travel these days, and anything helps. I do think that the people that we have are first-rate——

Senator VOINOVICH. But the question is this. Your plate is much fuller than it ever has been in this country's history and you have been operating with 200 people and you have been accessing personnel from other agencies. The question is whether or not your agency should be expanded and some of the expertise that you are relying upon in other agencies should be reorganized into your operation.

Mr. FREEMAN. Again, we have taken a variety of steps at USTR to deal with the expanded agenda. We have reorganized our issues and regional offices to deal with the new demands. We have overhauled the financial system that allows us to track travel expenses and so forth. We put new accounting codes in. There is a variety of other systemic things that we have done.

At the core of USTR is the notion that smaller is better, that the ability to be agile and nimble and to be responsive is really at the heart of some of our successes. That said, we do rely very heavily on both the detailee program that comes from other agencies and we also rely very extensively on our ability to work closely with other agencies.

Again, the bottom line is that it is good to be small, but the job is certainly tough and——

Senator VOINOVICH. Do you know if anybody is looking at it?

Mr. FREEMAN. Looking at the——

Senator VOINOVICH. The issue of whether or not the way you are organized makes the most sense.

Mr. FREEMAN. I know. I am here with the Assistant USTR for Administration, who spends his waking and sleeping hours fretting about it, so I know he is looking very closely at it.

Senator VOINOVICH. Well, it is a question that I am going to continue to ask and I am asking Mr. Yager to get involved in it.

I want to thank you very much for being here. Your testimony has been encouraging and you certainly have a lot of challenges. What you are doing is really important for our country, for our national security, for our economic security, and I just want to say to you I appreciate your commitment and your service to the country, and let the folks that you work with know that we care about what they do. God bless them for what they are doing.

Our next panel is Franklin Vargo, Vice President of the National Association of Manufacturers; Tom Duesterberg, President and CEO of Manufacturers Alliance for Productivity and Innovation; and Tim Hawk, who is Vice President and General Manager of American Trim L.L.C.

I want to thank you for being here today with us. You all have had an opportunity to hear from our previous witnesses and I welcome your observations about some of the things that they have said in their testimony.

We will start out with Mr. Vargo. Mr. Vargo, I understand that you have had a lot of contact back and forth with our office and I am looking forward to sitting down with you to talk to you about some ideas that the National Association of Manufacturers has and how we can improve the situation that I consider to be in crisis proportions in some parts of this country, particularly in terms of our manufacturers, so thank you for being here.

TESTIMONY OF FRANKLIN VARGO,[1] VICE PRESIDENT, INTERNATIONAL ECONOMIC AFFAIRS, NATIONAL ASSOCIATION OF MANUFACTURERS (NAM)

Mr. VARGO. Mr. Chairman, thank you for inviting me. I am really honored to be here because you are one of the NAM's great heroes. You take backseat to nobody in pressing for the health of American manufacturing and for restoring 2.8 million jobs to America's working men and women and we thank you for that.

Mr. Chairman, the subject of your hearing is a very important one. Manufacturing is indeed in need of a lot of redressing of the ills that have happened over the years. I want to thank you for introducing, along with Senator Snowe, S. 1977, the SMART Act, and we would like to work with you on that.

As far as trade resources, the NAM pressed very hard for an increase in resources for both USTR and Commerce this year and I certainly hope the omnibus appropriations bill is going to pass this week because it provides an additional $7 million of resources to USTR that is very overdue for many years. For example, USTR is leading now in negotiating 16 different free trade agreements that are either being negotiated now or they are on the books.

But the immediate problem is absorbing China into the WTO. China is now in the second year of being in the WTO and everybody was willing to cut China slack the first year, and we understand that China has a lot of transition still to do. But there are problems that just cannot be allowed to lie around anymore, and I want to illustrate some.

[1] The prepared statement of Mr. Vargo with attachments appears in the Appendix on page 92.

Mr. Chairman, I am holding a pair of pliers in my hands. This is a pair of pliers made in China. The wholesale price in the United States is 49 cents. An NAM member makes a similar pair of pliers. The problem is that the steel in these pliers and the rubber is 61 cents, and steel and rubber is not cheaper in China than it is here. How do you take 61 cents of raw materials, manufacture it, package it, ship it across the Pacific Ocean, and sell it for 49 cents? Something is going on, and it is not just in pliers. It is in the area of fish cookers, plastic molds, and vibration mounting systems. We have members that are very concerned that these products are being either dumped or subsidized.

Now, a lot of Chinese companies don't have to repay their loans. Up to half of the loans are non-performing. Well, if I didn't have to repay my loan, I could sell very cheaply at wholesale.

Assistant Secretary Jochum said they are setting up an unfair trade practices team and I suggest they start with that pair of pliers right here.

You mentioned counterfeit goods. My testimony contains some pictures of real and fake Toro sprinkler heads here. Toro is a very well-known company, makes garden equipment and others. When we talk about counterfeiting in China, we are not talking about knock-offs of designer bags and perfumes. We are talking about pharmaceuticals that are filled with talcum powder. We are talking about windshield safety glass that will shatter. We are talking about lawn sprinklers that are exported from China around the world, and it has got to stop. Getting China into the WTO gave us rights we didn't have before and it is time to exercise them.

I will say, I really want to compliment the new Deputy U.S. Trade Representative, Ambassador Josette Shiner. She has been in her office only a couple of months and she has been to China three times on this single issue. She has adopted it as her highest priority. The Chinese, in response, have designated a deputy prime minister to get onto the subject.

USTR has agreed that this will be discussed not just in theory, Mr. Chairman, but we are going to take specific cases like this, identify where the factories are. We want those factories, we want the equipment destroyed. We want the people who are manufacturing those counterfeit goods arrested. We want criminal prosecution brought and we want to see decisive action on this. And if we don't get that, then we are going to have to move quickly to the WTO. We can't sit around.

One additional area that, Mr. Chairman, you did not mention in your initial remarks, and that is China is violating its WTO requirements very seriously in the semiconductor area, where imported semiconductors into China, including American-made, pay a 17 percent value-added tax, and that is fair. But if you design and make the chip in China, you get 14 percent rebated back to you, and that is not fair. That is totally in opposition to the national treatment under the WTO and to specific tax provisions in the WTO.

If we let this continue, our semiconductor industry, the research and development, our entire global leadership in micro-electronics risks moving over to China. The Semiconductor Association produced a detailed report and I would like to leave that with you, Mr.

Chairman. This is something that USTR needs to stop talking about and do something about.

You mentioned the currency. The Treasury has acknowledged in testimony before Congress that the Chinese are intervening. They are intervening heavily for the purpose of preventing the exchange rate from rising, and by inference, they are saying that if China did not intervene, the exchange rate would rise.

Well, it is time to do something about that. Secretary Snow has put this front and center. We are very grateful for that. But we need to see action from the Chinese. If they cannot move to a floating currency—they are a huge trading economy. They need to play by the rules. And in the meantime, they need to bring their currency up to something that resembles market rate. I will say one of the best estimates was done by Dr. Ernie Preeg, who works with Dr. Tom Duesterberg in the Manufacturers Alliance.

One additional point. We need to ensure that the Commerce Department is indeed able to use correct methodologies for dumping and for countervailing duties in China. We do have companies that say the Commerce Department, in their view, is not going about the job as well as it ought to in selecting what are called surrogate companies in a market economy, because China is a non-market economy. We are very concerned about the cases of fraud. I was very pleased to hear what Assistant Secretary Jochum said, but we need to pursue that more.

And we need to look at whether there needs to be some change in the law to make it plain that if there are subsidies in China—and Secretary Evans said that there are—that the countervailing duty statutes can be used even though China is a non-market economy. This may need legal clarification, Mr. Chairman.

In concluding, Mr. Chairman, certainly China trade are not the only problems or even the primary problem that American manufacturing faces. You mentioned the cost increases. Dr. Duesterberg's organization, the Manufacturers Alliance, and the NAM, as a matter of fact, this very morning had a press conference releasing this report on how structural costs are harming manufacturing in the United States. This report quantifies for the first time the magnitude, and by our initial estimates, these costs of additional healthcare, of litigation, of energy costs, are adding 22 percent to the cost of producing in the United States. Until we deal with that, Mr. Chairman, that is just like hanging out a sign saying, "Manufacturers are not welcome in the United States." Thank you, Mr. Chairman.

Senator VOINOVICH. Thank you, Mr. Vargo. Mr. Duesterberg, thank you very much for being here.

TESTIMONY OF THOMAS J. DUESTERBERG,[1] PRESIDENT AND CHIEF EXECUTIVE OFFICER, MANUFACTURERS ALLIANCE/MAPI

Mr. DUESTERBERG. It is a pleasure to be here. Mr. Chairman, I want to join Mr. Vargo in commending you for your leadership on this issue and thank you for having me before your Subcommittee.

[1] The prepared statement of Mr. Duesterberg appears in the Appendix on page 108.

I am going to try to give a little bit broader overview of the importance of manufacturing with a view to helping you to focus your efforts on some of the areas of trade enforcement that are of particular importance to manufacturing.

I want to begin by giving you a few facts and figures about why manufacturing is important to the overall economy. It is not only that it produces high-paying jobs, but we think that manufacturing is indeed the engine of growth for the American economy and for the global economy, and that fact is too often forgotten.

We recently published a book trying to explain why we think U.S. manufacturing is the engine of growth, and I will leave a copy with you, Mr. Chairman. Some of the things we looked at though, were that manufacturing is the center of productivity and innovation in the modern economy. Over 90 percent of new patent approvals in the United States come from the manufacturing sector. Two-thirds of all R&D now comes from the manufacturing sector.

Furthermore, the high-tech investment that is pioneered by the manufacturing sector, as one of the other witnesses indicated, spills over into other sectors of the economy, such as agriculture and such as the services sector, and allows them to introduce productivity gains, which are the source of increases in our standard of living.

Given this leadership position of manufacturing as a research oriented, innovation oriented sector, we think it is vitally important to the future of the American economy. Some of the indicators that we talk about are not only the excess productivity gain compared to the rest of the economy that comes from manufacturing and spills over into the services sector, but also the fact that high-technology goods, which on an average pay much higher wages and which add much more value than commodity-type consumer goods, are increasingly dominant in the American economy. I put some charts in my testimony regarding the increase in our high-tech exports in the last two decades.

That being said, there is starting to be something of an erosion in the position of the United States's ability to do research and development and, in turn, remain competitive in the advanced technology area. Some 35 percent of our exports now are in advanced technology products. But whereas in the 1990's we had a large trade surplus, peaking out at $38 billion a year in advanced technology products, we now estimate that this year we will have a trade deficit of about $25 billion in advanced technology goods.

The second part of my testimony looks at some of the other pressures on manufacturing. Mr. Vargo mentioned the study that we put out which indicates that the cost pressures that are externally imposed on the manufacturing sector add up to at least 22.4 percent of total unit labor costs. Given that labor costs are only about 11 percent of total costs, overall costs in manufacturing, this shows you the magnitude of the problem we are facing with these costs, such as litigation, which you mentioned, healthcare costs, natural gas costs, and the like. This has wiped out much of the incredible productivity gains that we enjoyed in the manufacturing sector over the last two decades.

Senator VOINOVICH. I just wanted to interrupt you on that one, just because you talk to a lot of people in this country and they say, well, we are not productive. We have had the greatest increase in productivity that we have ever seen in this Nation's history, and a lot of it is coming out of the manufacturing sector, a big part of it, as a matter of fact.

Mr. DUESTERBERG. It is——

Senator VOINOVICH. So we are not competitive because we aren't productive. Nothing could be further from the truth. Our guys are doing terrific jobs in terms of productivity. But it is all the other structural costs added onto the back of the manufactoring sector that is breaking it and hurting them in the global marketplace. And the real question is, how do we level the playing field?

Mr. DUESTERBERG. Let me say a few other things about that. One of the sources of our strength over the course of time is our commitment to research and development, and the Federal Government has always played a role in that. I put a lot of charts and graphs in my testimony showing that there has been a slow erosion in relative terms of our commitment to basic research and to encouraging people, students, to enter into the professions, such as engineering, mathematics, and the physical sciences, which are important to manufacturing and which provide the intellectual capital, the human capital, for these incredible productivity gains that come out of the manufacturing sector.

I noted that some of the notable Federal programs of the past, such as the Apollo program, which in the 1960's was supported with up to 0.75 percent of total GDP each year, paid immense dividends over the course of time in terms of our technology lead, which we still enjoy today.

Unfortunately, there has been a fall-off in the number of students entering these professions and in the amount of support that is going into research and development, both at the Federal level and at the industrial level. And as a result, even though we are still the technology leader in most of the areas that are important to manufacturing, that lead is eroding a slight bit and we need to address that.

Now, third, some of the things we need to be doing, we need to address these cost pressures through tax policy. Capital in America is taxed higher than anyplace else in the world except Japan. Healthcare policy, which you know, legal reform, regulatory reform, and in that context I would note that even our environmental costs are higher than most places in the world. We don't do it as efficiently as we should. Energy costs, which used to be a source of strength for industries like chemicals, where we had a trade surplus of substantial proportions 10 years ago and now we are in a trade deficit. So that needs to be addressed.

Finally, I would note that there are things in addition to trade policy that we need to be looking at, and in terms of trade policy, the importance of intellectual property protection and enforcement of intellectual property protection, which Mr. Vargo went into great detail on, is vitally important.

But we also need to do things like improve elementary and secondary education, support advanced training in engineering and the physical sciences. I think we need to establish clear and inspirational national goals for our space and national health research programs, both because they meet national needs and it would be a means to attract students to the academic disciplines needed to carry out these programs and which are the heart of modern manufacturing.

We need to support basic research. We need to support programs that ensure the development of technologies that meet national security threats. Without a robust and technologically advanced manufacturing sector, our national security would be called into question.

We need to streamline and accelerate the drug and medical device approval process with the Food and Drug Administration, which tends to retard the development of medical products which, after all, are manufactured goods.

We need to make the R&D tax credit a permanent part of the IRS code, and the U.S. Patent and Trademark Office needs resources to speed up its activities.

Mr. Chairman, I thank you for this opportunity to appear before you.

Senator VOINOVICH. Thank you very much.

Mr. Hawk, it is nice to have you with us today. I appreciate the fact that you and your team from Ohio were in Toledo when we had our listening session and then were willing to come to Washington and spend over an hour with Secretary Don Evans. I thought it would be important that you be here at this hearing so that the record will reflect your personal experiences and how small businesses are being effected by the global trade environment. I am glad you are here to speak on behalf of an Ohio based company to tell your story of how you have encountered some enormous burdens that you haven't experienced before in the life of your company. Thank you for being here.

TESTIMONY OF TIM HAWK,[1] VICE PRESIDENT AND GENERAL MANAGER, AMERICAN TRIM L.L.C.

Mr. HAWK. Thank you. I would like to thank the Subcommittee for allowing American Trim the opportunity to present today. American Trim is a 50-year-old manufacturing business that supplies component parts and assemblies to the automotive and appliance industry. We stamp, decorate, and finish products that are seen and used in many households and vehicle systems. We employ over 1,500 families and operate facilities in four States. I am a third-generation owner-operator.

Our company's tag line is, "Forming the Future." I hope today our small company might have an influence on the formation and enforcement of future trade laws, policies, and practices.

Today, I will provide an overview of why the U.S. manufacturing sector is losing jobs at an alarming rate. As you know, two million jobs have been lost and we have had 34 straight months of manufacturing job loss.

You have given me 5 minutes today and I will give you our company's "2-cent" perspective for why the loss and why the continued loss if action is not taken. Simply put, it is all about the other noncontrollable costs that we are saddled with that makes us uncom-

[1] The prepared statement of Mr. Hawk appears in the Appendix on page 130.

petitive. This includes rising healthcare, environmental, OSHA, and basic utility costs.

The part that I am holding up here has been made for more than 30 years. We have made over a billion of these. We have invested millions of dollars in high-tech automation to eliminate the labor cost to the manufacturing. My predecessors had the foresight to being and achieving the world's low-cost producer of this product. This product has two cents of labor content in it. Those costs include the labor to convert the metal from a flat piece of metal into a finished product and shipped to the customer.

Competitiveness and the viability of this product in the lives of our people and employees is being challenged by the low-cost labor countries and their ability to buy and process commodities (steel) cheaper than us. We recognize that China, India, and Indonesia offer labor rates at 90 percent cheaper to the United States. We don't consider that a factor in competing with them due to the automation and the productivity levels that we currently achieve.

I recently conducted a competitive bid process for that specific product. My goal was to understand the direct material and labor content associated with the product. Much to my surprise, material was 25 percent cheaper than what we could procure it for. The ability to start off with a 25 percent advantage to us is a bit alarming. I researched other materials and have found similar stories in different industries.

The purchasing power parity (PPP) seems to be out of balance. I am by no means an expert on currency manipulation and its inter-relationship with PPP. All I can surmise is that the playing field is tilted away from fair trade.

Now let us talk about the other costs besides material and labor. These costs are almost non-existent to low-cost labor countries. These include cost of healthcare, environmental and safety compliance,and utility costs.

As a percent of revenue, our company operates at a 22 percent cost disadvantage due to the unlevel playing field. As you can see, it is not necessarily about the two cents of labor in that part that is in front of me. It is all about all of the other cost drivers that we experience as part of it.

There appears no end in sight for the ongoing cost escalation in healthcare and utility costs. Natural gas, which is used to heat our facilities and run our manufacturing processes, have increased 122 percent since 1998. Healthcare costs have risen 63 percent since 1999, and is approximately 5 percent of total company revenue.

The original equipment manufacturers (OEMs) have been developing strategies for sourcing products in China for some time. This includes the likes of General Motors, Ford, General Electric, Whirlpool, and Electrolux. They all have very lofty goals for China sourcing. Ford has a target of $10 billion within the next 5 years. How many businesses do you think will be lost to that?

They have one simple message for us: Match the China price or else. The "or else" is being eliminated as a supplier and the continued creation of more job loss for Ohio. General Electric is in the midst of following through on the "or else" for our company, costing people their jobs and reducing the amount of taxes paid.

The OEs are strategically organizing their China efforts. They are developing in-country beach heads and establishing very elaborate commodity filters for evaluating products. Products are screened or plotted on two dimensions. One dimension is of value added for labor and relative packaging density. Packaging density relates to the ability to ship many parts in a container. If they have a high labor content and are likely candidates for importing.

I think we can all see why China is an attractive area and place to manufacture goods and why companies will continue to pursue sourcing goods in that region of the world. It is all about year-over-year cost reductions that are needed by large multinational companies. If there is nothing to do to level the playing field, small to mid-size manufacturing won't exist in Ohio.

I was asked by a government official if we have plans to manufacture products in China. I responded, "I thought it was about keeping and securing jobs in the United States and including the flow of taxes to the Government."

We are at a real crossroad and a heightened sense of urgency needs to take place. I stand here today wondering if anything will be done or if we will just watch another industry sector pass. I am a hopeful manufacturing romantic, but I realistically can't tell our employees that the future is prosperous and bright. Thank you.

Senator VOINOVICH. Thank you for being here today.

A couple of areas. You heard the testimony in response to my question about whether our trade agencies have the people to get the job done, and I think the National Association of Manufacturers, Mr. Duesterberg, and your organization, supported having an Assistant Secretary of Manufacturing.

The issue is, in your opinion, are they moving fast enough in this regard. And from your observations, do they have the people that they need to get the job done? Also, do you think that the suggestion of evaluating the way our trade agencies are organized ought to be looked at? We can't even seem to agree on how many agencies are involved with trade negotiations and enforcement. And then having the Trade Representative reaching into the other departments for the expertise, from my observation, and I have been involved in this a long time as Governor of Ohio and very much involved in trade and export and so on, it just isn't working. I would like to have your opinion on that.

Mr. VARGO. Mr. Chairman, before coming to the NAM, I had over 30 years at the Commerce Department in international trade. Several of those years, I worked for Assistant Secretary Duesterberg, who was a great boss.

There is no question that certainly in USTR they haven't had the resources they have needed for years. We pushed very hard, and I want to give Representative Frank Wolf, who chairs the Commerce, Justice and State Appropriations Subcommittee, a lot of credit for his tenacity to get funding above and beyond what the administration asked for for USTR, and that is in the omnibus appropriations bill and I certainly hope that is approved by the Senate this week. That bill also, thanks to your efforts, contains the Assistant Secretary of Manufacturing position.

So I think Commerce is moving in making plans. I know a lot of people in Commerce from my years, and they are certainly working on the plans to implement that, but they need the authorization and the money, which will be coming very shortly.

So yes, I am satisfied with that. We are looking forward eagerly to Commerce's manufacturing report, which is coming out a little bit later than we had expected. What we want is a report with good hard-hitting recommendations, so we are looking for that.

As far as the interagency process, my perspective is a little different because I came from the Commerce Department. I just don't think it is possible to have all the expertise in USTR. For example, what you really need in intellectual property, when you have the patent lawyers, the trademark lawyers, they are in PTO, the Patent and Trademark Office. I have not seen over the years a reluctance for those people and other experts in Customs and all the different agencies to work with the USTR.

Sometimes the USTR complains that, oh, we are not getting enough support. Other times you hear complaints that, well, USTR is just not turning to us. Those are the minority of cases. By and large, I think the organization is there. It is the determination to move, the determination to act, both in terms of——

Senator VOINOVICH. Do you think that the Assistant Secretary of Manufacturing is going to make—as I mentioned, the orchestra leader, do you think that is going to give them the zip they need to—I mean, you are talking about turnaround on the pliers and turnaround on this and turnaround on that. It just seems like it takes forever and a day to get anything done around here.

If you look at some of the things that have been around—intellectual property rights, for years China has violated them and, frankly, it seems they aren't doing anything differently. You just go one after another and it just doesn't seem like it is getting done.

Mr. VARGO. It is not getting done, but the tools are there. It is just a determination to use them. Americans are nice people. We want to work on a cooperative basis with others. But now that we have rights, we got China into the WTO, we need to enforce those rights.

The Assistant Secretary for Manufacturing, I think is a great idea. We support it. But there also needs to be high-level interagency coordination and there needs to be attention of the White House to manufacturing.

Senator VOINOVICH. So your attitude is that even though they are up to their ears in rattlesnakes in terms of new trade agreements, that some of the expertise that they are drawing from other departments, it is better they just leave them in those agencies and not bring them into international trade?

Mr. VARGO. No, sir. USTR does need to be augmented, but not by all these specialists. For full disclosure, I should state that my wife is the Assistant U.S. Trade Representative for the Americas and she has 11 out of the 16 trade agreements that are going to be negotiated, so I never see her. I know they are understaffed. But the detailed support in the tariff analysis, in trademarks, etc., we would just be creating two people instead of one.

Senator VOINOVICH. Are they getting the quality of people they need right now?

Mr. VARGO. They are.

Senator VOINOVICH. They are? Are they holding the people they have?

Mr. VARGO. They are, remarkably so, so many dedicated people in the career service, in Commerce, in USTR and other agencies. I was really proud to have been a part of that. But that is not to say they don't need more resources. They have needed them for years. The omnibus bill just kind of makes up for the deficiency of the last few years, and that will do for right now, but NAM is going to keep pressing for more in the next budget cycle.

Senator VOINOVICH. We are really trying now with these new human capital flexibilities. As you know, I have been working for 5 years to give these departments more flexibilities in keeping the people that they have and dealing with some of the systemic problems that they have and then trying to attract more people into them, and I am hoping that is going to help them do a better job with shaping their workforce so——

Mr. VARGO. Mr. Chairman, it will.

Senator VOINOVICH [continuing]. They can get their job done.

Mr. VARGO. It will, but the main thing is, we have to be willing to use the new rights that we have under the WTO and these individual trade agreements.

Senator VOINOVICH. How long do we give them to find out?

Mr. VARGO. I think we are there.

Senator VOINOVICH. What does that mean? A month from now? Two months from now? Three months from now?

Mr. VARGO. I think we are talking——

Senator VOINOVICH. How about the 301?

Mr. VARGO. Well, the NAM is in with quite a few other associations and the AFL–CIO. We don't see eye to eye with the AFL–CIO on everything, but we do on the currency and it has got to move forward. So we are developing a 301 case. I heard Charles Freeman, who is a good friend of mine, say, well, we haven't seen the legal basis, and that is true, but we are developing the legal basis.

Senator VOINOVICH. I want to help you with that.

Mr. VARGO. Thank you, sir.

Senator VOINOVICH. They should move forward and do it, and I know that with some of your members, the 201 was a little controversial, but the fact of the matter is that a lot did occur positively as a result of that. Now they have terminated it, but I think we were entitled to do that.

Mr. VARGO. We were.

Senator VOINOVICH. And if we don't use what we have, then you are going to see a lot of stuff coming out of Congress.

Mr. VARGO. Well, we owe it to a lot of our members, including Mr. Hawk, who is a fine member of the NAM, to get the job done.

Senator VOINOVICH. Yes.

Mr. DUESTERBERG. Mr. Chairman, could I comment just briefly? I want to reiterate the importance of something Frank Vargo said about interagency coordination, especially with regard to the new position of Assistant Secretary for Manufacturing.

That position simply isn't going to work unless it has the ability to command the resources of other agencies through an interagency process. That is why I am interested in your suggestion that the position report to the President. At a minimum, some interagency process which gives the Assistant Secretary for Manufacturing clear authority to command the resources of other agencies, perhaps in a fashion similar to USTR now is able to coordinate trade policy, is, I think, a necessity for that position to work.

Senator VOINOVICH. Let me tell you something. I think it has that priority. It deals with our economic security and it deals with our national security. The $64,000 question, Mr. Hawk, is how do we deal with this? It is not a level playing field.

The Chamber of Commerce and Tom Donahue and John Sweeney about a year or so ago had a press conference and said the healthcare system is broken. I mean, we have got people competing in the global marketplace with competitors that don't have healthcare costs. We have it right here in this country. Honda in Ohio competes with the Ford Taurus on their Accord. They have $1,750 less cost because they don't have the legacy costs that Ford Motor Company has.

And then the next issue is the subsidy in terms of steel and the behind the scenes, the loans that are never—in Korea, the banks, the auto companies, and the steel companies are all in bed together. It is just we are dealing with it, and somehow we have to figure out how we can level that playing field.

The environmental costs. As you may know, I have been fighting very hard to try and make sure that we don't go crazy in terms of some of the things that we want to do, eliminate coal, for example, and force us into natural gas. I keep telling my colleagues, if we put manufacturing out of business, and we will do that if we force all utilities to go to natural gas, which will exacerbate their heating costs, their electric costs—these jobs are going to another country, and the countries they are going to don't have the environmental laws that we have.

It just seems like there is a disconnect in this country about what is going on out there. We are still back 50 years ago when we were king of the mountain and we didn't have the competition.

You can't answer that question today, but I would like to have another hearing on the issue of how do we level the playing field. What things do we need to really direct our attention to to see how we can compensate for the fact that we are in a different environment than we were many years ago?

And also we need to look at the other issue of how much capacity do we need to have for our national security. I keep going into plant after plant. I ask them, where has this equipment been made? Italy, here, there, somewhere else. How come it is not being manufactured in the United States? It was that way when I was governor and today it is even worse. How far do you go? Do you just lose your machine tool business? I don't think we can do that. And somehow within the framework of all of this we have to figure it out. This is a challenge that we need to deal with.

Mr. HAWK. Mr. Chairman, when 80 percent of our selling price to our customers is wrapped up in material, if the Chinese and the other countries have an advantage to either manipulating their currency and an ability to purchase material, we are never going to be able to compete. The small, the medium-sized manufacturers, which we are, will all be gone. It is just a matter of time. And that is why the issue of urgency and being able to do something about currency and about any subsidies that may be happening and enforcing it. It is similar to having speeding laws and having no police officers out on the road to control and to monitor what is going on.

Senator VOINOVICH. And you can see this is a member who——

Mr. VARGO. Absolutely.

Senator VOINOVICH [continuing]. They want action and I want action.

Mr. VARGO. And they deserve it.

Senator VOINOVICH. They deserve action.

Mr. VARGO. We do, too.

Senator VOINOVICH. There is just too much talk, and they are concerned, and——

Mr. VARGO. If I could observe, though, Mr. Chairman, the first step in solving a problem is to know you have got a problem, and I do want to give Secretary Evans great credit under Secretary Aldonas at Commerce. The bus tours they took around Ohio, Michigan, Indiana, other States, they came back and they really understood to a degree they had not before that this is a serious problem for the United States.

So the first steps are being taken, but we can't let it go at that. Everything in this book, healthcare, energy costs, none of these are simple problems. That is why they haven't been dealt with. But I hope what we are seeing now is the urgency of understanding, difficult as they are, we have to solve them or, I will go back to what I ended my statement with, you can just hang out a sign saying, "Manufacturers not wanted."

Senator VOINOVICH. I want to thank you for being here. I think you played the case out. I think that you ought to know that this Senator is going to monitor this issue on a day-by-day basis. I am looking forward to your coming in to see me. I am interested in thoughts of how we can deal with this problem.

And last but not least, Mr. Vargo, I would like to talk to you and Jerry about the issue of some of your members, with their declarations to people like the folks from Lima, Ohio, about you are going to outsource this overseas. They are doing it to compete in the international marketplace, but they are destroying American jobs and to the extent that they may do well for a period of time. But if we lose our infrastructure, then who is going to provide the competition and are they going to end up in a situation that they don't want to be?

I think that in the manufacturing community, you ought to get the manufacturers, you have to get the Chamber, you ought to get the Business Roundtable, you ought to get in a room and start batting this back and forth about what are we doing. Do we not care anymore about the future of the country? Are we so interested in our bonuses in the next 4 years so I can make a big salary and retire and let somebody else worry about it?

I am really concerned about it. I am concerned about the environment in this country today. I am worried about my kids and grandkids. Are they going to have the same standard of living that I have been able to have? Is this young man going to go out of business? How many years have you been in business?

Mr. HAWK. Fifty years.

Senator VOINOVICH. Fifty years. Are they going out of business? That is the problem today. And these other guys with the big multinationals ought to be thinking about some of these people.

Mr. VARGO. Mr. Chairman, if I could comment, multinationals get a bum rap with too many people feeling—I am not saying that includes you, Senator—that they don't care about America, they don't care about producing here. It is not so. They are under enormous international pressures because of things like the overvalued dollar, the unlevel playing field. We have to address all of those. Believe me, American companies want to stay in America.

Senator VOINOVICH. OK, but the fact of the matter is that the answer to it is to get down and fight here——

Mr. VARGO. It is.

Senator VOINOVICH [continuing]. Not say, oh, we can't do anything about it.

Mr. VARGO. Right.

Senator VOINOVICH. Let us fly the coop. Let us take care of my next 5 years and let somebody else worry about this. Let us get them in a room now and say, look, we have got to do something about litigation. We have got to do something about healthcare. We have got to do something about environmental regulation. We want a good environment, but it has got to be balanced. We have to do something about the fact that some of these countries are competing with us and they subsidize the dickens out of their products so, in effect, we can't compete with them. Those are the things.

Mr. VARGO. Mr. Chairman——

Senator VOINOVICH. Get them on a piece of paper and deal with them and don't say, well, I am going to run away and let these poor other guys worry about it. I am OK.

Mr. VARGO. That is exactly right, Mr. Chairman. We look forward to working with you on that.

Senator VOINOVICH. Well, thanks very much for being here.

I want to make one point, that the record will stay open because some of my colleagues may have questions that they want answered, so I am going to leave it open and you may be getting some requests from them to submit answers to their questions.

Thank you. The meeting is adjourned.

[Whereupon, at 12:03 p.m., the Subcommittee was adjourned.]

APPENDIX

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Oversight of Government Management, the Federal Workforce and the District of Columbia, U.S. Senate

For Release on Delivery
Expected at 10:00 a.m., EST
Tuesday, December 9, 2003

HUMAN CAPITAL

Significant Challenges Confront U.S. Trade Agencies

Statement of Loren Yager, Director
International Affairs and Trade

GAO
Accountability * Integrity * Reliability

GAO-04-301T

December 9, 2003

GAO

Accountability·Integrity·Reliability

Highlights

Highlights of GAO-04-301T, a testimony before the Subcommittee on Oversight, of Government Management, the Federal Workforce and the District of Columbia, U.S. Senate

HUMAN CAPITAL

Significant Challenges Confront U.S. Trade Agencies

Why GAO Did This Study

Recent developments in global trade have created human capital challenges for U.S. trade agencies. At least 17 federal agencies, with the Office of the U.S. Trade Representative (USTR) as the lead, negotiate, monitor, or enforce trade agreements and laws. These agencies' strategies for effectively aligning their current and emerging needs in handling international trade functions and their human capital resources are critical to improving agency performance.

GAO was asked to summarize its recent studies to illustrate important human capital challenges arising from current trade developments as U.S. trade agencies strive to negotiate, monitor, and enforce existing trade agreements and laws. For this testimony, GAO discussed the challenges that USTR, the Commerce Department, and the Bureau of Customs and Border Protection are facing in light of three recent developments in international trade: (1) the increased importance of security, (2) the ambitious U.S. negotiating agenda, and (3) the shifting global trade environment.

www.gao.gov/cgi-bin/getrpt?GAO-04-301T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Loren Yager at (202) 512-4347 or YagerL@gao.gov.

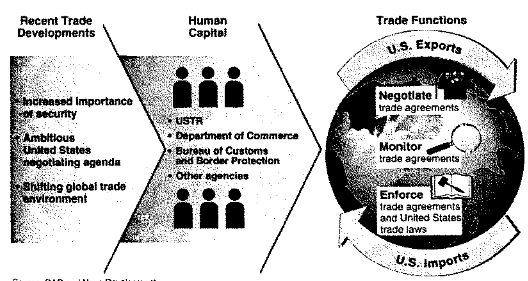
What GAO Found

The importance of international trade to the U.S. economy has grown in the last decade, as have the responsibilities of federal agencies involved in implementing international trade functions. For example, the September 11, 2001, terrorist attacks have heightened the need for increased focus on security within the global trade environment. In response, the Bureau of Customs and Border Protection has implemented new programs to improve the security of the global supply chain. These new programs require greater attention to human capital strategies to ensure that they achieve their goals of facilitating trade while preventing terrorist acts.

In addition, the administration has continued to pursue multilateral negotiations within the World Trade Organization and with the Free Trade Area of the Americas countries as well as a series of new, bilateral and subregional trade negotiations. The increase in the number of initiatives has strained available human capital, leading to a USTR request for additional staff.

Finally, the shifting global trade environment has complicated efforts to monitor and enforce trade agreements. For example, the United States has become the most frequent defendant in World Trade Organization trade dispute proceedings. Furthermore, as the U.S. economy has shifted toward services and high-tech industries, the industry advisory committees that provide trade advice to the U.S. government have required structural realignment to reflect these changes. Also, China's growing influence in international trade has resulted in new challenges to its trading partners. These changing global forces require U.S. trade agencies to continuously ensure that their human capital strategies closely link to the nation's strategic trade functions.

Recent Trade Developments Create Human Capital Challenges in Performing Trade Functions



Source: GAO and Nova Development.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the implications of recent trade developments on the human capital strategies of major U.S. trade agencies that negotiate, monitor, and enforce trade agreements and laws. International trade is an increasingly important part of the U.S. and world economy: In 2001, world exports represented about one quarter of the world's gross domestic product (GDP), partly as a result of the succession of trade agreements that have reduced trade barriers. However, this dynamic trade environment and the growing number of trade agreements have also resulted in a significant burden on U.S. trade agencies—and their human capital—as they strive to monitor and enforce existing trade agreements and laws while simultaneously negotiating a number of new agreements.

As we have reported in numerous studies and testimonies before this Subcommittee and other congressional Committees, effective alignment between the current and emerging needs and U.S. federal agencies' human capital strategies is critical to improved agency performance. For this testimony, you asked us to summarize some of our recent studies to illustrate important human capital challenges confronting trade agencies that have arisen from recent trade developments. Specifically, today I will focus on the human capital challenges that trade agencies face in light of three recent trade developments:

- the increased importance of security,
- the ambitious negotiating agenda of the United States at the current time, and
- the shifting global trade environment.

While numerous agencies have trade responsibilities, we are focusing today on the Office of the U.S. Trade Representative (USTR) and the U.S. Department of Commerce because of their key roles and responsibilities for implementing trade functions, that is, negotiating, monitoring, and enforcing trade agreements and laws. In addition, we also discuss the Department of Homeland Security's Bureau of Customs and Border Protection (CBP), because it has primary responsibility for ensuring the security of trade in the post-9/11 environment. In performing this work, we have drawn on a number of our recent reports, some of which directly addressed human capital issues, and have also interviewed officials from relevant trade agencies.

Summary

The terrorist attacks of September 11, 2001, have heightened the need for increased security within the global trade environment. Combating terrorism became the number one priority for CBP and has significant implications for its human capital strategies and trade functions. Our recent work indicates that it is too soon to tell how the increased importance of security will affect the implementation of CBP's trade-related activities over the long run; however, some short-term shifts in human capital from trade to nontrade functions have occurred. Also as part of its focus on terrorism, CBP has implemented new programs to screen high-risk containers for weapons of mass destruction at overseas ports and to improve security in the private sector's global supply chain. Our recent work in this area found a need to link human capital strategies with the goals of facilitating trade and combating terrorism to establish accountability and ensure effective performance.

In recent years, the United States has been pursuing a broad trade policy agenda whose cumulative impact has tested the limits of the government's negotiating capacity. The administration has continued an ambitious negotiating agenda relating to the ongoing World Trade Organization (WTO)[1] and Free Trade Area of the Americas (FTAA) multilateral negotiations, plus a series of new, bilateral and subregional trade negotiations following the passage of the Trade Act of 2002.[2] Our work in this area shows that pursuing such a broad negotiating agenda has strained available resources, leading to requests for additional staff in recent years.

Finally, the shifting global trade environment complicates efforts to monitor and enforce existing agreements, placing a substantial burden on the human capital resources of U.S. trade agencies. Based on our recent work, the United States has become the most frequent defendant in WTO trade dispute resolution proceedings. In addition, as the U.S. economy has shifted toward services and high-technology industries, our recent work shows that the industry committee structure that provides advice to U.S. trade agencies has required realignment to reflect these changes. Finally, a new set of challenges has also evolved in response to China's growing

[1]The WTO is a multilateral organization, established in January 1995, that administers rules of international trade and provides a forum for conducting trade negotiations among its 146 members as well as a dispute settlement system for resolving trade disputes among its members.

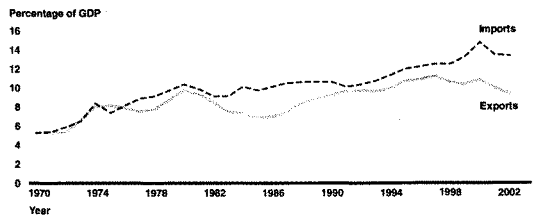
[2]Pub. L. No. 107-210, 116 Stat. 933, 993-1022.

influence in international trade. Our work shows that these forces have stretched the human capital resources of U.S. trade agencies. Although the government has taken steps to address some of these challenges, these and other changes in the global trade environment require that the trade agencies constantly monitor and update their human capital strategies to ensure that they are closely linked to the strategic goals of the agencies.

Background

U.S. exports as a share of U.S. gross domestic product have grown significantly, increasing from less than 6 percent in 1970 to a peak of more than 11 percent in 1997, as shown in figure 1. The rise in U.S. imports was even greater, increasing from about 5 percent in 1970 to nearly 15 percent of GDP in 2000, according to Commerce Department statistics. Although the share of U.S. exports and imports has declined from those peak levels, they still represent a substantial part of our GDP—at 9.3 percent, and 13.3 percent, respectively, in 2002. The U.S.'s principal trading partners include Canada, Mexico, Japan, and China.

Figure 1: U.S. Exports and Imports as a Share of GDP, 1970-2002

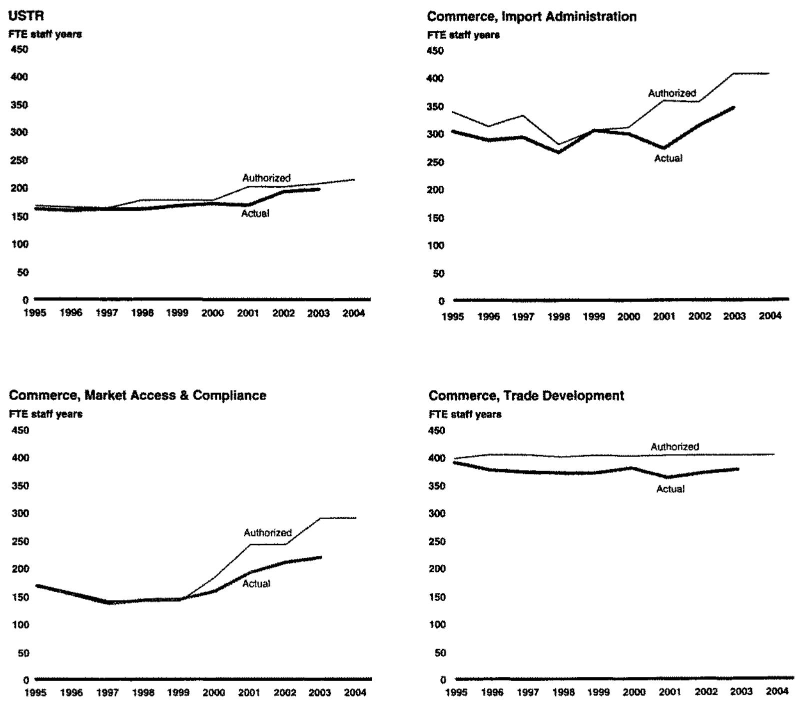


Source: GAO analysis of Bureau of Economic Analysis data.

At least 17 federal agencies, led by USTR, are involved in developing and implementing U.S. trade policy. USTR's role includes developing and coordinating U.S. international trade policy and leading or directing negotiations with other countries on trade matters. It also has primary statutory responsibility for monitoring and enforcing U.S. trade agreements. The Department of Commerce has a relatively broad role with respect to trade agreement activities, with three units in the International Trade Administration performing the key trade functions: The Import Administration helps enforce U.S. trade laws; Market Access and Compliance is responsible for ensuring that other nations live up to their trade agreements; and Trade Development focuses on advocacy for U.S. companies, export promotion services, support for trade negotiations, and market analysis. Trade functions at the CBP are primarily directed toward enforcing U.S. import and export laws and facilitating legitimate trade as well as collecting duties, fees, and other assessments (more than $23 billion in fiscal year 2002). Other agencies also play important roles, such as the departments of Agriculture and State, which have relatively broad roles with respect to trade agreement activities. The departments of the Treasury and Labor have more specialized roles, such as advising on financial services or labor and workers' rights issues. Federal trade policy development and monitoring and enforcement efforts are coordinated through an interagency mechanism comprising several management- and staff-level committees and subcommittees.

The number of authorized full-time staff at USTR, Commerce's Import Administration, and Commerce's Market Access and Compliance division has increased in recent years (see fig. 2). However, actual staff levels are still in the process of catching up with authorized levels in Commerce and USTR offices. USTR has requested additional staff resources for 2004.

Figure 2: Authorized and Actual Full-time Equivalent (FTE) Staff Years at USTR and Commerce's Key Trade Offices, 1995-2004



Sources: USTR and Department of Commerce data.

Note: The authorized level shown for 2004 is based on the administration's budget request for fiscal year 2004.

As of January 23, 2003, the CBP had 3,269 positions dedicated to performing trade-specific functions: 2,263 specialists, auditors, and attorneys and 1,006 associated positions[3] carry out trade activities such as auditing trade compliance; processing entry documents; collecting duties, taxes, and fees; assessing and collecting fines and penalites for noncompliance; and advising on tariff classification issues. CBP is expected to maintain these staff levels, as the Homeland Security Act of 2002 stipulates that the Secretary of Homeland Security may not reduce the staffing levels attributable to such functions on or after the effective date of the act.[4] In addition, more than 18,000 CBP inspectors perform trade and nontrade functions depending on the nature of their assignment. For example, inspectors may screen and inspect cargo for illegal transshipment of textiles, counterfeit cigarettes, illegal drugs, and other contraband; and enforce compliance with U.S. trade and immigration laws.

The Increased Importance of Security Has Significant Implications for Human Capital Strategies and Trade Functions

After September 11, 2001, combating terrorism became the priority mission for the U.S. Customs Service and remained so when the Customs Service was transferred to the Department of Homeland Security and incorporated into CBP. While it is too soon to tell how the increased importance of security will affect the implementation of CBP's trade-related activities in the long run, some short-term shifts in human capital from trade to nontrade functions have occurred. As part of its focus on terrorism, CBP has implemented new programs to screen high-risk containers for weapons of mass destruction at overseas ports and to improve security in the private sector's global supply chain. CBP has made progress in getting these programs up and running but has not devised systematic human capital plans to meet long-term staffing needs for both programs. The increased importance of security requires human capital strategies that link with the goals of combating terrorism and facilitating trade to establish accountability and ensure effective performance.

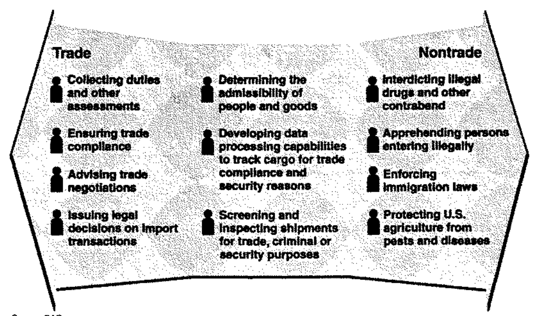
[3]Associated positions support the specialists, auditors, and attorneys and include positions such CBP managers, paralegals, account managers, and clerical staff dedicated to trade activities.

[4]Section 412(b)(2) of the Homeland Security Act, Public Law 107-296, 116 stat. 2180, states that the Secretary of Homeland Security may not reduce the staff levels attributable to functions performed by the following personnel and their associated support staff: import specialists, entry specialists, drawback specialists, national import specialists, fines and penalties specialists, attorneys of the Office of Regulations and Rulings, Customs auditors, international trade specialists, and financial systems specialists.

Combating Terrorism Becomes a Priority, Shifting Human Capital from Trade Activities

The historical mission of the U.S. Customs Service has been to collect customs revenues and ensure compliance with trade laws, but this mission has shifted over time. For example, in the 1970s Customs expanded its functions to include the interdiction of narcotics entering the United States. Since September 11, 2001, combating terrorism has become Customs' priority mission, culminating in the creation of CBP on March 1, 2003. On that date, the U.S. Customs Service was transferred from the Department of the Treasury to the Department of Homeland Security as part of the Homeland Security Act of 2002.[5] Figure 3 illustrates the range of trade and nontrade activities that CBP performs.

Figure 3: Range of CBP Activities



Source: GAO.

While two of the nine key mission-related offices within CBP[6] are primarily dedicated to trade, most offices and most of CBP's more than 40,000

[5]CBP was formed through the merger of most of the U.S. Customs Service and immigration inspectors and the U.S. Border Patrol of the former Immigration and Naturalization Service and the agricultural border inspectors of the U.S. Department of Agriculture. While most of Customs transferred to CBP, its Office of Investigations did not. Instead, the more than 5,000 Customs investigators and staff were transferred to the Bureau of Immigration and Customs Enforcement within the Department of Homeland Security.

[6]The Office of Strategic Trade and the Office of Regulations and Rulings are the two offices within CBP that are primarily dedicated to trade.

employees perform a range of activities that support both trade and nontrade goals. Moreover, about a fifth of the 3,269 CBP positions dedicated to performing trade activities are located in the trade-specific offices, but most are located in offices that support both goals. Within this kind of organization, activities performed by persons in the offices that support both goals could shift from trade to nontrade activities when security threat levels are higher without actually seeing a reduction in the number of staff dedicated to trade. Moreover, the activities of the 18,000 plus CBP inspectors who perform trade and nontrade functions could shift to focus on combating terrorism when security concerns are heightened.

Several examples illustrate the types of shifts from trade to security activities that have occurred.

- After September 11, 2001, CBP temporarily detailed approximately 380 inspectors to international airports around the country to strengthen security measures—reducing the number of inspectors available to work on trade activities.
- During the first 2 quarters of fiscal year 2002, CBP audits on export compliance were not conducted so that 150 inspectors could be temporarily redeployed to land ports along the northern border to strengthen security measures.
- During fiscal year 2002, the Compliance Measurement program, which determines compliance with U.S. trade laws, regulations, and agreements, was temporarily discontinued for 11 months because import specialists and inspectors were redirected to border security activities. Due to the limited compliance sampling, CBP was unable to calculate an overall trade compliance rate for fiscal year 2002. Moreover, compliance measurement helps ensure the quality of trade data, and unreliable trade data increase the risk that critical threats will not be identified.
- In fiscal year 2003, 3 of 14 scheduled textile production verifications were canceled when the national security alert level increased, so that the verification teams could remain at their ports and field offices to focus on security-related activities. The textile production verification teams, comprised of CBP import specialists and special agents, examine the production facilities in nations where there is potential for illegal transshipment of textiles.

While the Homeland Security Act stipulates that the Secretary of the Department of Homeland Security may not reduce the staffing levels attributable to specific trade-related activities, our examination found that measuring inputs such as the number of staff assigned to trade-related positions does not adequately capture possible shifts away from trade activities—as the number of people assigned to trade-related positions may remain the same, but the focus of their work may shift to nontrade duties. In addition, those positions that were not included in the legislation, such as inspectors, but conduct trade and nontrade activities, may increasingly shift their focus away from trade and concentrate on homeland security activities. Measuring changes in CBP's outputs and outcomes will be important in assessing how the increased emphasis on combating terrorism and Customs' transfer to the Department of Homeland Security have affected trade activities and whether human capital strategies need to be readjusted accordingly.

New CBP Antiterrorism Programs Paid Little Attention to Human Capital Planning

Responding to heightened concern about national security since 9/11, CBP assumed the lead role in improving ocean container security and reducing the vulnerabilities associated with the overseas supply chain. In November 2001, CBP initiated the Customs-Trade Partnership Against Terrorism program, where companies agree to voluntarily improve the security of their supply chains in return for reducing the likelihood that their containers will be inspected for weapons of mass destruction. In January 2002, CBP also initiated the Container Security Initiative whereby CBP officials are placed at strategic foreign seaports to screen cargo manifest data for ocean containers to identify those that may hold weapons of mass destruction. We reported in July 2003[7] that CBP had not taken adequate steps to incorporate human capital planning, develop performance measures, or plan strategically- - factors crucial to the programs' long-term success and accountability.

Initially, 10 officials were assigned to roll out the Customs-Trade Partnership Against Terrorism. Under the program, companies enter into partnership agreements with CBP and agree to self-assess their supply chain security practices and document it in a security profile. These 10 officials provide guidance to companies on how to prepare their security profiles as well as review the completed security profiles and prepare feedback letters. As of May 2003, more than 3,300 agreements had been

[7]U.S. General Accounting Office, *Container Security: Expansion of Key Customs Programs Will Require Greater Attention to Critical Success Factors*, GAO-03-770 (Washington, D.C.: July 25, 2003).

signed, 1,837 security profiles reviewed, and 1,105 feedback letters prepared. However, early on CBP realized that it did not have a cadre of staff with the skills necessary to conduct site visits to observe supply chain practices and make substantive recommendations for improving security. In October 2002, CBP began the process of developing a new position, called "supply chain specialists," to review company security profiles, visit companies to validate information contained in the security profiles, and develop action plans that identify supply chain vulnerabilities and the corrective steps companies need to take. CBP was authorized to hire more than 150 supply chain specialists and expected to hire 40 supply chain specialists in fiscal year 2003. As of October 2003, CBP has visited more than 130 companies to verify their supply chain security practices. While CBP officials acknowledged the importance of human capital planning, they said they had not been able to devote resources to developing a human capital plan that outlines how the program will increase its staff 15-fold and implement program elements that require specialized training.

The Container Security Initiative seeks to deploy 120-150 inspectors, intelligence research analysts, and agents to 30 overseas ports by the end of fiscal year 2004. CBP eventually plans to expand to 40 to 45 ports. Deploying four-to-five person CSI teams to foreign ports will be a complex, multiyear task. CBP seeks candidates with specialized skills needed to review cargo manifest data and identify suspicious containers for inspection as well as diplomatic and language skills to interact with their foreign counterparts. While CBP officials told us that they did not experience significant difficulties in finding qualified staff to fill their short-term human capital needs from among the pool of existing CBP employees, CBP had only 12 ports up and running under the Container Security Initiative at that time (May 2003). In addition, the teams were on 120-day temporary duty assignments; however, CBP plans to create 2- to 3-year assignments to replace the 120-day temporary duty assignments. In spite of the potential challenges CBP could face, CSI officials had not devised a systematic human capital plan.

To help ensure that the Container Security Initiative and the Customs-Trade Partnership Against Terrorism achieve their objectives as they transition from smaller start-up programs to larger programs with an increasingly greater share of the Department of Homeland Security's budget, we recommended in July 2003 that CBP develop human capital plans that clearly describe how these programs will recruit, train, and retain staff to meet their growing demands as they expand to other countries and implement new program elements. Human capital plans are particularly important given the unique operating environments and personnel requirements of the two programs. According to CBP officials, the professional and personal relationships that supply chain specialists and the Container Security Initiative teams build with their clients over time will be critical to the long-term success of both programs. For example, the success of the Customs-Trade Partnership Against Terrorism will depend, in large part, on the supply chain specialists' ability to persuade companies to voluntarily adopt their recommendations. Similarly, a key benefit of the Container Security Initiative is the ability of CBP officials to work with foreign counterparts to obtain sensitive information that enhances their targeting of high-risk containers at foreign ports. If CBP fails to establish these good working relationships, the added value of screening manifest data at foreign ports could be called into question.

Ambitious Set of Ongoing Negotiations Creates Demands for Additional Staff

In recent years, the United States has been pursuing a broad trade policy agenda whose cumulative impact has tested the limits of the government's negotiating capacity. This agenda includes undertaking significant negotiating efforts in multilateral, regional, and bilateral arenas. The administration has characterized this effort as a strategy of "competitive liberalization." First, the United States is actively involved in the challenging WTO round of negotiations launched in Doha, Qatar, in 2001. Second, the United States is also a co-chair in ongoing negotiations to create a Free Trade Area of the Americas. Finally, with the passage of trade promotion authority in 2002,[8] the United States has also launched a series of bilateral and subregional free trade agreement negotiations. The increase in the number of these negotiations at the same time that major global and regional trade initiatives are under way has strained available resources.

WTO Negotiations Had Ambitious Schedule for September 2003 Cancun Ministerial

The United States is committed to completing a new round of WTO negotiations. In November 2001, the WTO, with strong backing from the United States, launched a new set of multilateral negotiations at its ministerial conference in Doha. As we reported in September 2002, the ministerial conference laid out an ambitious agenda for a broad set of new multilateral trade negotiations as described in the Doha Ministerial

[8] Pub. L. No. 107-210, 116 Stat. 933, 993-1022.

Declaration.[9] The Doha mandate calls for the continuation of negotiations to liberalize trade in agriculture and services. In addition, it provides for new talks on market access for nonagricultural products and negotiations on trade and the environment, trade-related aspects of intellectual property rights, and a number of other issues. The breadth of the negotiations means that USTR will need to call on staff from a number of trade agencies to assist USTR throughout the process. USTR has also asked for additional staff to address the increased workload.

Despite recent problems, WTO negotiations are likely to continue to command staff attention. Doha Round WTO negotiations are currently on hold following a breakdown at the September 2003 Ministerial Meeting in Cancun, Mexico, throwing the 2005 deadline for completion of the negotiations in doubt. After the ministerial, WTO officials initially canceled all special negotiating sessions and later called for a senior officials' meeting by December 15, 2003. Despite these developments, however, USTR officials do not anticipate any decrease in staff workload on WTO issues because of the breadth of their ongoing WTO responsibilities and their efforts to restart the negotiations.

Major U.S. Role in Final Phase of FTAA Talks Expands USTR's Negotiations Workload

We reported in April 2003[10] that, as the co-chairman, with Brazil, of the FTAA negotiations, USTR has faced a heavy expansion of its workload. Demands on USTR resources increased significantly in fall 2003, when USTR's responsibilities as co-chair of the negotiations and host of the ministerial intensified due to preparations for the November 2003 Miami FTAA ministerial. The co-chair's formal tasks include

- coordinating with Brazil on a daily basis;
- providing guidance and management coordination to the FTAA Administrative Secretariat;
- providing guidance to the negotiating groups and committees; and

[9]U.S. General Accounting Office, *World Trade Organization: Early Decisions Are Vital to Progress in Ongoing Negotiations*, GAO-02-879 (Washington, D.C.: Sept. 4, 2002).

[10]U.S. General Accounting Office, *Free Trade Area of the Americas: Negotiations Progress, but Successful Ministerial Hinges on Intensified U.S. Preparations*, GAO-03-560 (Washington, D.C.: Apr. 11, 2003).

- co-chairing key FTAA committees.

In terms of resources, the U.S. team negotiating the FTAA—though perceived as highly capable—is small and stretched thin. Like past chairs, USTR has dedicated some staff specifically to the co-chair function, while other USTR staff work on advancing the U.S. position in the negotiations. In addition, USTR made arrangements with other agencies for temporary assistance. For example, Commerce provided a detailee who worked full time in Miami beginning in July, and State provided both foreign service officers and conference specialists to help host and conduct the ministerial.

U.S. Pursuing Simultaneous Negotiations on Numerous FTAs

Bilateral negotiations are also applying pressure to trade agencies' human capital resources. In addition to the WTO and the FTAA negotiations, USTR has notified Congress of its intent to pursue free trade agreements (FTA) with a number of countries and has started negotiations toward this end. The passage of trade promotion authority in 2002 gave U.S. negotiators the opportunity to pursue trade agreements with other countries under a streamlined approval process in Congress. The administration sees FTAs—some with a single country (i.e., bilateral) and others with groups of countries (i.e., subregional)—as opportunities to promote the broader U.S. trade agenda by serving as models and breaking new negotiating ground.

The United States is now negotiating four FTAs and intends to pursue others soon. In late 2002, it began negotiating the Central American Free Trade Agreement with Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua; the Southern Africa Customs Union Free Trade Agreement with South Africa, Botswana, Lesotho, Namibia, and Swaziland; and FTAs with Morocco and Australia. In mid-2003, the administration also announced that it plans to negotiate FTAs with the Dominican Republic and Bahrain and in mid-November announced plans for an FTA with Panama. Thailand and Sri Lanka are also being considered as FTA partners. With the breakdown of WTO negotiations, the U.S. Trade Representative has stated that the administration will focus on FTAs with willing partners to continue making progress in trade liberalization.

USTR officials acknowledge that human capital impacts are associated with conducting these FTAs. Each agreement involves a variety of different subjects, and negotiations on most of these agreements are complex. In particular, staffing constraints affect the timing of new negotiations, because staff with regional responsibilities are limited by the extent to which they can support additional negotiations. In addition, completed FTAs will require additional work to monitor compliance with the terms of the agreement.

Pursuing an ambitious set of negotiations on an international, regional, and bilateral basis is having a cumulative impact on the human capital capacity of agencies that conduct trade negotiations. Since USTR's staff size of 199 is relatively small—having been set up to coordinate policy among and draw expertise from executive branch agencies—it relies on the departments of State, Commerce, Agriculture, the Treasury, and others to provide assistance and additional issue area expertise. However, USTR officials told us that their staff are already responsible for supporting multiple negotiations. Although these officials stated that USTR has taken steps to work more efficiently with other agencies, they have nevertheless requested additional resources, as shown in figure 2, in order to face the anticipated negotiations workload. For example, a recent USTR budget request noted that current staff would not be able to handle the combination of WTO, FTAA, and FTA responsibilities required in the areas of services and investment.

Shifting Global Forces Complicate Monitoring and Enforcement Efforts and Place Substantial Demands on Human Capital Resources

Shifting global forces have complicated trade agreement monitoring and enforcement efforts, thus posing human capital challenges for U.S. trade agencies. For example, we recently reported that the United States has become the most frequent defendant in WTO trade dispute resolution proceedings, particularly in the trade remedy area. As a result, U.S. agencies have had to devote substantial staff resources to handle these cases, and USTR has requested additional staff to address the upward trend in dispute settlement cases. We also reported that the U.S. economy has shifted toward services and high-technology industries, while the industry committee structure that provides advice to U.S. trade agencies has been heavily weighted toward the agriculture and manufacturing sectors. Changing the committee structure to reflect the current economy and keeping its membership current has required U.S. trade agencies to devote staff resources to this effort. Finally, we reported that China's rapid expansion in the world economy presents U.S. trade agencies with significant human capital challenges as they strive to monitor and enforce compliance with trade agreements with China. Although the U.S. government has taken steps to address some of these new challenges, questions remain about the alignment of human capital with the rapidly growing set of responsibilities we discussed in our reports. These three examples demonstrate the kinds of shifts that occur in the trade arena and indicate the impacts that these changes can have on human capital. In each of these cases, the shifting global forces require the United States to respond, and an effective response requires a clear link between the trade agencies' human capital strategies and the goals of the agencies in that changing environment.

United States Is Most Frequent Defendant in WTO Dispute Settlement Activity, Requiring Substantial Human Capital Resources

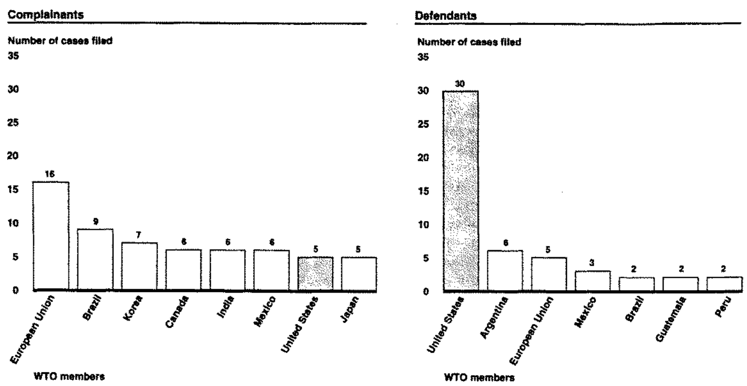
Shifting global forces in the trade arena can be seen in recent trends in the WTO, the principal organization that regulates international trade, as members act to monitor and enforce trade agreements. For example, the United States has become by far the most frequent defendant in WTO dispute settlement cases.[11] Many WTO disputes in recent years have concerned its members' use of trade remedy measures whereby members impose duties or import restrictions after determining that a domestic industry has been injured or threatened with injury by imports.[12] As shown in figure 4, the United States was a defendant in 30 of the 64 trade remedy cases brought from 1995 through 2002, with more than half of those cases filed since January 2000.[13] The next most frequent defendants were Argentina, which had six cases, and the European Union, a defendant in five cases. On the other hand, the United States was less active than other WTO members in filing trade remedy cases. As figure 4 shows, the European Union was the most frequent complainant in the 64 trade remedy cases, and six WTO members filed more complaints than the United States did between 1995 and 2002.

[11]The dispute settlement system applies to disputes between members arising under the WTO agreements. See U.S. General Accounting Office, *World Trade Organization: Standard of Review and Impact of Trade Remedy Rulings*, GAO-03-824 (Washington, D.C.: Sept. 24, 2002).

[12]Of 198 cases filed in the WTO from 1995 through 2002, about one-third (64 cases) pertained to members challenging other members' trade remedies—antidumping or countervailing duties or safeguard measures. The remaining two-thirds of the cases pertained to nontrade remedy issues such as application of sanitary and phytosanitary measures, intellectual property rights, textiles and clothing, and trade-related investment measures. The 198 cases originated from 276 separate requests for consultations or filings—the first of four phases in the dispute settlement process. We combined multiple requests for consultation regarding the same measure or law into a single case.

[13]The United States was a defendant in 26 of the 108 nontrade remedy cases brought from 1995 through 2002.

Figure 4: Most Frequent Complainants and Defendants in WTO Trade Remedy Cases, 1995-2002



Source: GAO analysis of WTO data.

U.S. officials stated that some WTO trade remedy rulings have been extremely difficult to implement. For instance, some rulings have placed a greater burden on domestic agencies to establish a clearer link between increased imports and serious injury to domestic industry. As a result, officials said they would now have to expend more resources in conducting such investigations. In addition, U.S. officials said that the rulings have required U.S. agencies to provide more detailed explanations of their analyses and procedures for applying several methodologies used in trade remedy investigations.

As a result of the increased WTO dispute settlement activity, U.S. trade agencies have had to devote substantial staff resources to handle these cases. According to Commerce officials, about one-half of the Import Administration's 36 attorneys are significantly engaged in handling WTO litigation. They said Commerce has sufficient staff to handle the current workload unless the number of dispute settlement cases increases. According to USTR, the number of WTO cases its lawyers have handled has increased dramatically—from 11 in 1995, to 53 in 1997, to 69 in 1999, and to 91 in 2002. USTR expects this trend will continue, both because more and more WTO members are making active use of the dispute settlement system but also because there are more WTO members. Although the number of USTR General Counsel staff attorneys has roughly doubled since 1995 (with 13 new positions added in fiscal year 2001), the lawyers that were added are more than fully occupied with the current workload, USTR said. As a result, USTR has requested another monitoring and enforcement attorney for fiscal year 2004 to handle the increasing dispute settlement work.

WTO trade remedy rulings and the broader set of proceedings within the WTO are an important component of the international set of obligations and agreements to which the United States is a party. Our review found that the United States has become a focus of complaints in trade remedy cases, and U.S. agencies stated that some of the rulings on these cases have important implications for the future, including potential workforce implications. This situation requires trade agencies to maintain human capital strategies that anticipate and respond quickly to any changes. Doing so would allow them to allocate staff accordingly to keep the trade functions current and relevant.

Changing Structure of the U.S. Economy Requires Trade Agencies to Modify the Industry Advisory Committee System

The changing structure of the U.S. economy has required a strategic realignment of some trade functions. For example, the trade policy advisory committee system[14] performs an important function through which private sector committee members are able to provide input to trade agencies to help them negotiate, monitor, and enforce trade agreements; however, our September 2002 report[15] found that the structure and composition of the trade advisory committee system had not been fully updated to reflect changes in the U.S. economy and U.S. trade policy.

[14]Under section 135 of the Trade Act of 1974, 19 U.S.C. § 2155, the President is required to seek information and advice from the private sector on (1) negotiating objectives and bargaining positions before entering into a trade agreement, (2) the operation of trade agreements, and (3) other matters regarding the administration of U.S. trade policy. A system of trade advisory committees was established in the 1970s to serve this purpose. In 2002, the system comprised about 735 advisers spread across 34 committees. The advisory committees are administered by USTR, which assumes a leadership role, along with several other departments, especially Commerce.

[15]U.S. General Accounting Office, *International Trade: Advisory Committee System Should Be Updated to Better Serve U.S. Policy Needs*, GAO-02-876 (Washington, D.C.: Sept. 24, 2002).

Although the U.S. economy had shifted toward services and high-technology industries since the 1970s, their representation on the trade advisory committees had not kept pace with their growing importance to U.S. output and trade. For example, certain manufacturing sectors, such as electronics, had fewer members than their sizable trade would have indicated. In other cases, U.S. negotiators reported that some key issues in negotiations, such as investment, were not adequately covered within the trade advisory committee system. In addition, committee rosters were only about 50 percent of their authorized levels, and some large companies did not participate, limiting the availability of advice for negotiators from certain committees.

Our 2002 report also found that the resources USTR and the other trade agencies devoted to managing the trade advisory committee system did not match the tasks that needed to be accomplished to keep the system running reliably and well. For example, USTR officials told us that the current staffing levels in its responsible office—three positions with multiple responsibilities—did not allow them time to proactively manage committee operations. The head of the office said that simply restarting all the lapsed committees and keeping the rest of the system operating were occupying much of the time she could devote to the system. Commerce, which co-administers many of the trade advisory committees, faced similar challenges. As discussed in our September 2002 report, Commerce officials said they had to focus their limited staff—an office of three persons—on rechartering the committees and appointment processes, which did not allow them to meet their responsibilities to attend all the committee meetings.

We recommended that USTR work with Commerce and several other agencies to update the trade advisory system to make it more relevant to the U.S. economy and trade policy needs as well as to better match agency resources to the tasks associated with managing the system. According to recent information that agencies provided, their staff have planned and, in some cases, already taken a number of actions in response to our 2002 recommendations that they expect will increase efficiencies and reduce the workload. For example, Commerce and USTR have developed a plan for restructuring the industry advisory committees that officials believe better reflects the U.S. economy. Under the plan, some new committees are to be established, while the overall number of committees is to be reduced. The latter action is expected to reduce the administrative workload for Commerce's staff, enabling them to focus more on substantive matters. The plan also calls for quarterly plenary meetings that will be open to all trade advisors. According to Commerce officials, bringing all advisors together at the same time will facilitate a higher level of representation of U.S. trade negotiators at the meetings and that, as a result, trade advisors will be better informed about ongoing negotiations. In turn, the officials said, trade advisors should be better prepared to deliberate on issues of interest to them and thus better able to provide advice to U.S. trade negotiators.[16]

In addition, the agencies revised their process for clearing proposed new members, thus reducing the amount of time it takes for clearance. Moreover, a secure Web site has been established that allows members to review the texts of draft trade negotiating documents. In addition, the Assistant U.S. Trade Representative for Public Liaison now holds a monthly teleconference with the chairmen of all committees. During this call, USTR provides feedback to committees on previously raised areas of concern or recommendations, discusses USTR's long-term negotiating calendar to highlight upcoming issues, and is open to discussion of general issues or concerns. According to Commerce and USTR officials, they have taken these actions without increasing the size of their authorized staffs. However, it was noted that Commerce staff, who did much of the implementing work on this issue, sometimes put in long hours in completing their tasks. In addition, in the case of Commerce, a position that had been vacant was filled, thus increasing the actual number of staff.

While administering the trade advisory committee system is only one of many functions that trade agencies perform, the system does provide an important forum for candid discussion of trade negotiating topics with a wide range of private sector experts. Our review found that the system has not realized its potential, however, and that lack of administrative support was one of the reasons for this situation. While the agencies have taken actions to improve the trade advisory committee structure and its management, these kinds of improvements illustrate how U.S. trade agencies need to utilize human capital strategies that anticipate and respond to shifts in global market forces. Such an effort would allow the agencies to allocate staff accordingly to keep trade functions current and relevant.

[16]On November 25, 2003, USTR and the Department of Commerce announced that the plan has been approved and the agencies expect to implement it by March 2004.

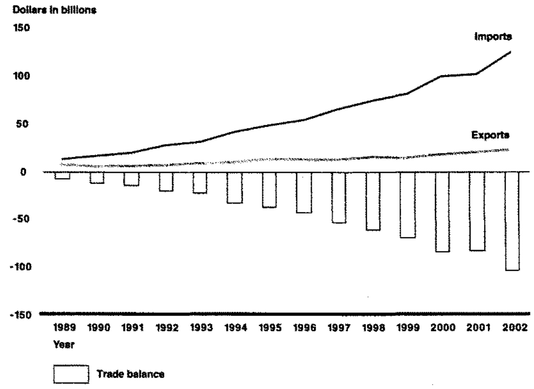
Growing Importance of China Creates Range of Human Capital Challenges for Trade Agencies

China's rapid expansion in the world economy presents U.S. trade agencies with significant human capital challenges as they strive to monitor and enforce compliance with trade agreements. In 2002, China was the United State's fourth largest trading partner. The rapid growth of China's exports to the United States and the continuing role of the government in China's economy create a significant challenge for U.S. agencies and the Congress to ensure that U.S. businesses are treated fairly. Since China's entry into the WTO on December 11, 2001, U.S. agencies have taken significant actions to monitor and enforce an extensive and complex set of WTO commitments. Among these actions are increasing staff resources, establishing an interagency group to focus on China trade issues, and considering organizational changes to better concentrate analytical staff resources. However, early experiences with monitoring China's compliance with numerous and complex commitments and with WTO and U.S. government mechanisms for enforcing commitments illustrate just how difficult and resource intensive—particularly in terms of human capital—this task will be.

Size and Scope of China's Impact on U.S. Markets Are Considerable

U.S. trade with China has been characterized by a rapidly growing deficit, with a significant impact on a number of industries in the United States. As figure 5 shows, U.S. imports from China have grown rapidly since 1989, while U.S. exports to China have also expanded, but at a much slower rate. The growing trade deficit has been addressed at several congressional hearings and may require greater attention from Commerce, USTR, and other trade agencies.

Figure 5: U.S. Exports, Imports, and Balance of Merchandise Trade with China, 1989-2002



Source: GAO analysis of Department of Commerce data.

In 2002, imports from China totaled nearly $125 billion, accounting for nearly 11 percent of total U.S. imports and making China the third largest supplier of U.S. imports, after Canada and Mexico, respectively. The top five U.S. imports from China are shown in table 2 (see the app.). China was the seventh largest market for U.S. exports in 2002, and U.S. exports totaled about $21 billion or 3.2 percent of total U.S. exports to the world (see table 3 in the appendix).

Continuing Role of Chinese Government in the Economy Creates Challenges for Monitoring and Enforcement

China has made important progress during the past 25 years in opening its market to foreign goods and services as well as foreign investment, according to a USTR report.[17] Economic and financial reforms have introduced market forces into China, and privileges accorded state-owned

[17]USTR, *2003 National Trade Estimate Report on Foreign Trade Barriers* (Washington, D.C.: Mar. 31, 2003).

firms are gradually being removed. However, the transition from a state-controlled economy to a market-driven one is far from complete. According to USTR, reforms have been particularly difficult in sectors that traditionally relied upon substantial state subsidies as the central government continues to protect noncompetitive or emerging sectors of the economy from foreign competition. Moreover, USTR said, provincial and lower-level governments have strongly resisted reforms that would eliminate sheltered markets for local enterprises or reduce jobs and revenues in their jurisdictions, inhibiting the central government's ability to implement trade reforms.[18] During 2003, the Commerce Department held more than 20 roundtable discussions with U.S. manufacturers, both large and small, across the United States and heard similar complaints. According to Commerce's under secretary for the International Trade Administration, no foreign country raised more attention as a source of concern than China. Manufacturers complained about rampant piracy of intellectual property, forced transfer of technology from firms launching joint ventures in China, a broad range of trade barriers, and capital markets that are largely insulated from free-market pressures.[19]

Another issue concerns the Chinese government's decade-long practice of pegging the Chinese yuan to the dollar as a means, according to Chinese officials, of fostering economic stability, the absence of which could hurt its export industries and political stability. In order to maintain this fixed exchange rate, the government has had to intervene in the foreign exchange market and, according to Treasury officials, recently intervened

[18]In 2002, we surveyed the views of U.S. companies with business activities in China about prospects for China implementing its WTO commitments. Seventy percent or more of the responding companies identified rule of law-related commitments to be the most difficult for China to implement. These included (1) consistent application of laws, regulations, and practices; (2) intellectual property rights; (3) enforcement of contracts and judgments/settlement of disputes in the Chinese court system; (4) equal treatment between Chinese and foreign entities; and (5) transparency of laws, regulations, and practices. See U.S. General Accounting Office, *World Trade Organization: Selected U.S. Company Views About China's Membership*, GAO-02-1056 (Washington, D.C.: Sept: 22, 2002).

[19]In mid-October 2003, the U.S.-China Security and Economic Review Commission concluded that China was supporting its manufacturers through a range of national industrial policies, such as, for example, tax relief, preferential loans from state banks, and requirements for foreign investors to provide foreign technology transfers. The commission recommended that USTR and Commerce identify whether any of China's industrial policies are inconsistent with its WTO obligations and engage with the Chinese government to mitigate those that are significantly impacting U.S. market access. (The commission, created on October 30, 2000, consists of 12 members who were appointed on the basis of recommendations made by the leadership of the House and Senate.)

very heavily to prevent the yuan from appreciating against the dollar. Considerable debate has occurred among experts and observers about whether China's intervention to maintain a lower-valued yuan is having a negative effect on U.S. manufacturers. This issue has been the subject of numerous congressional hearings with administration witnesses and was also a topic of discussion between Presidents Bush and Hu Jintao at the October 2003 Asia Pacific Economic Cooperation Economic Leaders' Meeting and during the Secretary of the Treasury's September 2003 trip to China. Also in September, the Group of Seven[20] finance ministers issued a statement favoring more flexibility in exchange rates for large economies. In an October 30, 2003, report to the Congress, the Treasury Department concluded that no major trading partner of the United States was manipulating the rate of exchange between its currency and the U.S. dollar for the purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade. However, the report also found that China's fixed exchange rate was not appropriate for a major economy like China and should be changed. According to the Treasury, the Chinese government has indicated it will move to a flexible exchange rate regime but believes taking immediate action would harm its banking system and overall economy.

The growing importance of the Chinese economy for the United States has been a particular focus of attention from U.S. officials due to the implications for U.S. firms and for compliance with trade agreements. However, these issues require increasing attention from U.S. agency personnel. Moreover, as in the case of the debate surrounding the Chinese currency, these issues require appropriate expertise from U.S. trade and economic agencies, and a resolution of these matters may ultimately require a significant investment of time from these officials.

China's Accession to the WTO Strains Agencies' Monitoring Resources

As we reported in October 2002,[21] China's WTO commitments span eight broad areas and require both general pledges and specific actions. We identified nearly 700 individual commitments on how China is expected to reform its trade regime, as well as commitments that liberalize market access for more than 7,000 goods and nine broad service sectors in

[20]Seven leading industrialized countries of the world, including Canada, England, France, Germany, Italy, Japan, and the United States.

[21]U.S. General Accounting Office, *World Trade Organization: Analysis of China's Commitments to Other Members*, GAO-03-461 (Washington, D.C.: Oct. 3, 2002).

industries important to the United States, such as automobiles and information technology. Owing to the breadth and complexity of China's commitments, China's accession to the WTO has led to increased monitoring and enforcement responsibilities for the U.S. government.

An illustration of the human capital difficulties involved in monitoring and enforcing China's commitments relates to U.S. government efforts to establish an interagency group—the China WTO Compliance Subcommittee—whose mandate is to monitor China and the extent to which it is complying with its WTO commitments. Almost 40 officials, representing 14 departments and executive offices, participate in this subcommittee. The subcommittee was very active in 2002, meeting 11 times. In these meetings, officials evaluated and prioritized current monitoring activities, reviewed the steps that China has taken to implement its commitments, and decided on appropriate responses. Also, the subcommittee held a public hearing on September 18, 2002, and USTR issued its first annual report to Congress on China's WTO compliance on December 11, 2002, as required by law.

Still, it took some time for the subcommittee to get up to full speed. For example, the various participants had to work out their respective roles and responsibilities. USTR officials sought to delineate tasks related to carrying out their monitoring action plan in China; Washington, D.C.; and Geneva (the WTO's headquarters), including expectations for information gathering, reporting, and setting initial priorities. Finally, USTR officials undertook several activities at the beginning of the year to educate themselves on China's WTO obligations. This was important, because monitoring these obligations entailed new or expanded responsibilities for officials in the field, and many of the Washington-based officials were relatively new to their current jobs. For example, many of the USTR officials who had actively participated in the U.S. negotiations with China that resulted in those obligations changed jobs and/or left the government soon after China became a WTO member in 2001.

U.S. Agencies Have Added Staff and Are Considering Further Organizational Changes

USTR, Commerce, and other agencies have requested and received additional resources to carry out the added responsibilities arising from China's accession to the WTO. For example, full-time equivalent staff in key units that are involved in China monitoring and enforcement activities across four key agencies increased from about 28 to 53 from fiscal year 2000 to 2002, based on agency officials' estimates (see table 1).

Table 1: Agency Staffing Estimates for Key Offices Involved in China WTO Compliance Efforts, Fiscal Years 2000-02

Agency	2000	2001	2002
USTR	3	3	5
Department of Commerce			
Market Access and Compliance	7	19	22
Import Administration	1.7	3.3	6.7
Department of Agriculture	7.5	7.5	10.5
Department of State	8.25	8.25	8.75
Total	**27.5**	**41.1**	**53**

Source: U.S. General Accounting Office, World Trade Organization: First-Year U.S. Efforts to Monitor China's Compliance, GAO-03-461 (Washington, D.C.: Mar. 31, 2003).

Commerce had the largest overall increase in staff devoted to China WTO compliance during this period. Specifically, staffing levels in Commerce's Market Access and Compliance division increased from 7 to 22 between fiscal years 2000 and 2002. Additionally, Commerce's Import Administration, which takes the lead on monitoring China's commitments concerning subsidies and unfair trade practices, also significantly increased staff dedicated to China compliance activities during the same time period. Commerce has also increased the number of staff involved in the agency's compliance efforts on the ground in China by creating a Trade Facilitation Office within the U.S. embassy in Beijing. In addition, the Department of Agriculture has increased the number of overseas staff involved in the agency's China WTO compliance activities.

A Commerce official told us that the Import Administration is thinking of combining all of its China work under one deputy assistant secretary (the current practice is to distribute the work among three deputy assistant secretaries). Doing so might enhance the office's expertise and provide a better basis for assessing whether additional China expertise is needed.

Conclusions

As we have reported in numerous studies and testimonies before this Subcommittee and others, effective alignment between federal agencies' human capital approaches and their current and emerging strategic and programmatic goals is critical to the ability of agencies to economically, efficiently, and effectively perform their missions. The importance of such a close alignment is demonstrated in the area of the U.S. government's trade activities, where heightened security concerns, an ambitious trade negotiating agenda, and an array of global economic forces all have implications for sound human capital management.

Our testimony has cited illustrations in these three areas based on our recent work for Congress. In some areas, failure to sufficiently plan the human capital approach, such as the CBP programs to secure the global supply chain, show that the success of the programs is not assured in the absence of human capital planning. In other cases, such as the U.S.'s ambitious trade negotiating agenda, human capital resources may be a constraint on the ability of the trade agencies to carry out their negotiations at the multilateral, regional, bilateral, and subregional level. Finally, the array of shifting global forces described in some of our recent studies also demonstrates the implications for U.S. trade agency activities and, in many cases, the agencies' human capital activities. For example, in the case of the rapid growth of China in the world economy and its WTO accession agreement, the demand for specialized expertise and focus on issues related to China's economy have led to growth in personnel and efforts to reorganize to meet these new monitoring and compliance challenges.

As your Subcommittee has stressed in its guidance and hearings regarding other parts of the federal government, agencies must constantly reevaluate their human capital strategies to adapt and even anticipate major shifts in their environment. We believe that a number of studies we have performed for Congress in recent months are good illustrations—and further evidence—of the validity of that approach.

Mr. Chairman and members of the Subcommittee, this concludes my prepared statement. I will be pleased to answer any questions you or other members of the Subcommittee may have at this time.

Contacts and Acknowledgments

For further contacts regarding this testimony, please call Loren Yager at (202) 512-4347 or Christine Broderick (415) 904-2240. Individuals making key contributions to this testimony included Adam Cowles, Etana Finkler, Kim Frankena, Wayne Ferris, Rona Mendelsohn, Anthony Moran, and Richard Seldin.

Appendix: U.S. Imports from and Exports to China, 1989-2002

This appendix provides information on U.S. imports from and exports to China during the past 14 years. Table 2 provides data on the top five U.S. imports from China between 1989 and 2002. Together, imports of these five commodities accounted for about 59 percent of total imports from China in 2002, according to the Department of Commerce.

Table 2: Top Five U.S. Imports from China, 1989-2002 (Dollars in millions)

Year	Miscellaneous manufactured items	Office machines	Telecommunication equipment	Footwear	Electrical machinery	Total
1989	$2,529	$70	$1,032	$720	$535	**$11,859**
1990	3,236	117	1,142	1,475	652	**15,120**
1991	4,094	290	1,466	2,532	876	**18,855**
1992	5,932	543	1,752	3,396	1,331	**25,514**
1993	7,151	932	2,279	4,505	1,723	**31,425**
1994	8,690	1,583	3,715	5,254	2,252	**38,572**
1995	10,319	2,879	4,215	5,817	3,094	**45,370**
1996	11,867	3,562	4,438	6,367	3,874	**51,209**
1997	14,155	5,019	5,126	7,354	4,877	**61,996**
1998	15,872	6,329	6,405	8,016	5,707	**70,815**
1999	17,291	8,239	7,382	8,438	7,022	**81,522**
2000	19,445	10,980	9,812	9,206	9,037	**99,581**
2001	19,782	10,762	10,062	9,767	9,048	**102,069**
2002	23,495	15,230	14,145	10,242	10,217	**124,796**

Source: Department of Commerce data.

Note: Miscellaneous manufactured articles include toys and games. Telecommunication equipment includes sound recording and reproducing equipment such as telephone answering machines, radios, tape recorders and players, televisions, VCRs, and so forth.

Table 3 provides figures on the top five U.S. exports to China between 1989 and 2002. Together, these five commodities accounted for about 42 percent of total U.S. exports to China in 2002.

Table 3: Top Five U.S. Exports to China, 1989-2002 (Dollars in millions)

Year	Transport equipment	Electrical machinery	General industrial machinery	Specialized machinery	Office machines	Total
1989	$540	$138	$268	$359	$147	**$5,775**
1990	754	133	176	322	133	**4,776**
1991	1,084	132	222	370	148	**6,238**
1992	2,051	207	275	423	161	**7,339**
1993	2,252	247	427	669	213	**8,619**
1994	1,929	285	515	670	233	**9,178**
1995	1,187	408	712	675	306	**11,613**
1996	1,718	553	764	685	254	**11,801**
1997	2,127	684	756	765	324	**12,533**
1998	3,604	931	663	519	830	**13,908**
1999	2,325	1,252	675	478	697	**12,585**
2000	1,695	1,502	812	744	1,154	**15,335**
2001	2,452	1,842	1,051	773	1,208	**17,959**
2002	3,382	2,185	1,105	1,102	913	**20,553**

Source: Department of Commerce data.

Note: Transport equipment is primarily aircraft and parts. Office machines are mainly computers.

Prepared Testimony of
Assistant Secretary of Commerce for Import Administration
James J. Jochum
Before the Senate Committee on Governmental Affairs Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia

December 9, 2003

Thank you Chairman Voinovich, Senator Durbin, and Members of the Subcommittee for inviting me to discuss the enforcement of trade laws and the Bush Administration's plan to boost jobs and help domestic manufacturers. I appreciate your dedication to this issue, and I further appreciate your giving me the opportunity to discuss the Administration's efforts in this regard.

For the President and Commerce Secretary Don Evans, the importance of trade extends well beyond the economic realm. As the President stated:

> "open trade is not just an economic opportunity, it is a moral imperative. When we negotiate for open markets, we are providing new hope and promoting political freedom."

It is because of the economic and social imperative behind trade that the Administration has moved aggressively in pursuing an ambitious trade agenda. We will continue to move forward to expand our trade and the economic opportunities that it creates for all Americans, and to eliminate barriers to the free flow of American goods, services, investment and ideas.

Today's hearing offers me the chance to review some of our findings from the more than 20 roundtable discussions the Department of Commerce held with U.S. manufacturers, both large and small, across the country as part of the President's Manufacturing Initiative. It also allows me to put that initiative and our trading relations, particularly with China, in an appropriate context among the other issues raised by U.S. manufacturers.

The Economic Context of Manufacturing

One of the most important things to understand about manufacturing is that it plays a major role in the overall success of the U.S. economy. The President understands the importance of manufacturing to our economy, our workforce, and to our future. It represents 14 percent of our gross domestic product and 13 percent of total private sector employment.

Manufacturing innovations at home and abroad are important for agriculture and services. Advances in John Deere's cotton-picking equipment manufactured in Des Moines, Iowa, for example, make cotton producers throughout the south and west more efficient and productive. Advances in servers produced by Cisco and Sun Microsystems enable hospitals across the country to offer both higher quality and lower cost health care to millions of Americans. And, nano-technology manufacturing techniques being funded through the National Institute of Standards and Technology have already found their way into the market, offering U.S. semiconductor manufacturers a critical edge in making the next generation of microprocessors.

Having said that, there is a growing perception that American manufacturers are weak, cannot compete, and are being "hollowed out." Much of that stems from the significant pressure that many U.S. manufactures have faced due to the recent downturns in the economy and stiff competition from abroad.

That is why I always like to emphasize that, even in the face of significant challenges, American firms have built the strongest, most dynamic manufacturing sector in the world. The United States remains far and away the largest producer and exporter of manufactured goods in the world. Standing alone, our manufacturing sector would rank as the 5th largest economy in the world – larger than the entire economy of China.

However, fostering an economic environment that attracts investment in manufacturing is key to maintaining the United States' position as the world's leader in manufacturing. And, the key to attracting that investment is ensuring that we offer a competitive environment from which manufacturers can produce not just for the U.S. market, but also globally.

That is why manufacturing not only matters, but also obviously is worth fighting for. Fortunately, the stimulus of the 2001, 2002, and 2003 tax cuts has softened the blow from the recent downturn and set the stage for vigorous economic growth going forward. Indeed, in the third quarter of this year, the U.S. economy expanded at an extraordinary pace of 8.2 percent – the best economic growth in almost 20 years. It now appears that manufacturing, after many months of very slow growth, is beginning to participate in the broader economic recovery. The most recent report from the Institute of Supply Management (ISM), which tracks growth in manufacturing sector shipments through its Purchasing Manager's Index has registered five consecutive months of strong growth and projects stronger growth in manufacturing sales ahead. In fact, the ISM's manufacturing index of 62.8 in November was the highest reading since December 1983.

Even on the employment front, there are very good signs of job growth that are consistent with a stronger economy. The most recent figures from the Labor Department reveal that the unemployment rate, at 5.9 percent in November, has trended down since mid-year. Further, during the past four months, the national economy has added 328,000 jobs while the unemployment rate has fallen 0.3 percentage points.

Just to put that in perspective, many economists agree that due to rapid policy responses, the recent economic downturn was shallower than most others in the past, and unemployment, with the exception of a rise to 6.4 percent in June of this year, generally stayed within 5.6 and 6.1 percent throughout the early stages of the recovery. It is worth noting that in 1993, according to an article in the *Wall Street Journal*, then-President Clinton was encouraging the Congress to take a hard look at our unemployment insurance programs on the grounds that we were at full employment by historical standards – at the time unemployment stood at 6.8 percent. We are now under 6 percent.

The positive news associated with the recovery does not negate the fact that the manufacturing sector has lost well over 2 million jobs during the recent downturn. What has surprised most economists has been the fact that manufacturing has continued to shed jobs even during the recovery. While the recovery in overall employment appears to have begun in earnest, the manufacturing sector is still losing jobs, although at a much slower rate.

What that points to is more fundamental and structural changes under way in manufacturing, both in the United States and globally. One of the causes, ironically, is the same rising productivity that is key to maintaining U.S. competitiveness in manufacturing. Employment in manufacturing has been declining for over three decades due to productivity gains throughout the U.S. manufacturing sector. American manufacturers are finding ways to do more with less, meaning it now takes considerably fewer hours of labor to produce the same quantity of output.

In the last two years, however, productivity growth has accelerated yet further. The increase in manufacturing productivity during the last two-year period, as the economy began to recover, was higher than any two-year period since 1977. In effect, while those productivity gains have helped manufacturers regain their competitive position, they have also meant continuing job losses in the manufacturing sector as a whole.

Stronger economic growth will eventually result in greater hiring, even in manufacturing, but much will depend on the level of business investment. Business investment is still recovering from the excesses of the late 1990s. That too is reflected in the job figures. The most recent job losses in manufacturing began in 2000 when the manufacturing sector entered into a recession about 10 months earlier than the economy as a whole.

In addition, the competition in manufacturing is now more global than ever before. The combined effects of rapid changes in communications, new transportation technology, the end of Cold War economic divisions, and the global lowering of trade barriers, have made the global market place a modern reality. In practical terms, that means expanded markets for U.S. exports, but also stiffer competition in manufacturing, both in export markets and, here at home, from imports.

World trade statistics bear that out. In 1980, the United States, Europe, and Japan accounted for roughly 75 percent of world exports of manufactured goods. Twenty years later, they account for 60 percent of world exports of manufacturers – a drop of 15 percentage points. Some 7 percentage points of that share went to the Asian "tigers" of Singapore, Taiwan, Hong Kong and Korea. But, by far the largest individual gain in market share went to China, which has increased its percentage of world exports from near zero in 1980 to 5 percent in 2002.

More global competitive pressure has meant continuing downward pressure on prices and profit margins due to the excess capacity on the market for manufacturers worldwide, not just in the United States. That is why a recent study by Allied Capital Management showed that China had actually lost more in the way of manufacturing employment than the United States during the last 15 years in percentage terms.

In short, our manufacturers are facing a competitive environment and we should foster an environment in which our firms can compete and succeed in manufacturing. That is why President Bush and everyone in his Administration are committed to working towards an economic climate where everyone who wants a job has that opportunity and our manufacturers remain on top in terms of their competitiveness.

The President's Manufacturing Initiative

The foregoing discussion helps set the context for the President's Manufacturing Initiative. In March of this year, during Manufacturing Week, Secretary Evans had the opportunity to speak before the National Association of Manufacturers in Chicago. At that time, he announced the President's Manufacturing Initiative. As a part of that initiative, Secretary Evans directed Under Secretary for International Trade, Grant Aldonas, to lead a comprehensive review of the issues influencing the long-term competitiveness of U.S. manufacturing. The central goal of the review is to develop a strategy to ensure that government is fostering an environment that promotes a dynamic manufacturing industry.

The Commerce Department's senior management, including Secretary Evans and Deputy Secretary Bodman, all pitched in. Roundtable discussions were held with manufacturers in the aerospace, automotive, semiconductor, and pharmaceutical sectors, among others, in more than 20 cities across the United States – from North Carolina to Columbus, Ohio, to Detroit to Los Angeles – to develop the report and recommendations.

What we heard from manufacturers in terms of the challenges they face was significant. While the international competition is what has garnered most of the attention in the press, by far the greater weight of the manufacturers' comments focused on domestic issues – what we call "keeping our side of the street clean." This simply means paying attention to the needs of our manufacturers as we develop legislation or implement regulations. It is the steady accumulation of multiple burdens, rather than a single cause, that has had the most severe impact on the competitive environment in which our manufacturers operate.

The list of issues our manufacturers identified should not surprise anyone who has taken a serious interest in manufacturing. While our manufacturers have tightened their belts and raised their productivity in an effort to remain competitive and, in fact, to succeed in the day-to-day competition in the marketplace, they have seen hard-won productivity gains eroded by everything from higher energy costs to higher medical and pension costs to higher insurance costs due to a run-away tort system.

Just a few examples might suggest why manufacturers have seen their costs rise. In Columbus, Ohio, Des Moines, Iowa, and Minneapolis, Minnesota, we met with manufacturers in the plastics and adhesives businesses that are heavy users of natural gas. The companies in the plastics businesses in particular risk seeing whole new markets fall to their foreign competitors who see lower natural gas prices. If we are serious about manufacturing, we have to adopt a national energy plan that will help us access new sources of supply and improved transmission to reduce the cost of energy to our manufacturers as well as to consumers.

We heard from manufacturers in New Jersey that 30 cents of every dollar of revenue went to pay health benefits for employees. Manufacturers gladly pay for their employee's health benefits because they see their own interest served by a healthy and motivated workforce, but if we are serious about manufacturing, we have to be serious about grappling with the underlying drivers that have created 145 percent increases in health care insurance costs that obviously are not sustainable indefinitely.

In Michigan, officials met with auto parts suppliers that faced continuing pressure from the auto companies to lower their prices by 20 percent or face the prospect that the auto companies would turn to overseas sources of supply. The concern those parts suppliers reflected involve the terms on which they compete with those overseas suppliers, particularly in China. But the auto parts suppliers knew that the ultimate source of the problem lay in an auto industry that is grappling with the same sorts of legacy costs that burdened the steel industry. If we are serious about manufacturing, then these industries will have to get those financial obligations under control.

Another example that we heard from virtually every manufacturing trade association we met with was the need to eliminate the complexity and the disincentives our tax system creates for investing in manufacturing in the United States. A number of issues fall into that category. Take the current tax code treatment of equity financing, which raises the cost of capital, thereby reducing the investment. This treatment also translates into a preference for debt, which yields highly leveraged companies and a highly leveraged country, all the while encouraging the worst sorts of gaming as clever tax lawyers try to find ways to take what is an equity interest and call it debt in order to qualify for an interest deduction. Taken together, even without cutting rates, reforms of the tax code could make a profound difference to the relative attraction of investing in manufacturing in the United States.

But, perhaps the most egregious example comes out of the tort system in this country. One issue, in particular, stood out among the manufacturers' concerns about the tort system. That was the ongoing asbestos litigation. There, the continuing litigation has yet to help many individuals who were harmed by prolonged exposure to asbestos, while, at the same time, the litigation hangs over the heads of virtually all U.S. manufacturing, raising their insurance costs and dampening their returns. Clearly, if we are serious about manufacturing, we have to get serious about reforming the tort system.

Manufacturers also pointed to declining vocational school programs, declining enrollments in engineering and the funding of scientific research, all of which are essential to the productivity gains that keep our manufacturing sector competitive and keep a skilled workforce employed. This Administration is committed to investing in the types of retraining programs our workers need to develop the skills.

In addition to keeping our own side of the street clean, U.S. manufacturers demanded a level playing field internationally. What that means in practical terms is an effort to eliminate tariff and non-tariff barriers to our exports through negotiation with our trading partners, and the vigorous enforcement of both the existing international trade rules and U.S. trade laws. The goal is simply to ensure that everyone on the field is subject to the same rules of the game.

The Administration is willing to exercise the legal remedies available under the WTO and U.S. law. That said, we have also pursued other more practical means to address the problem. For example, to help enforce rule of origin requirements in import preference programs and free trade agreements, and eliminate illegal transshipment, the Commerce Department contracted with the Oak Ridge Laboratories to identify potential "marker" systems to help determine the origin of imports. Three technologies were determined by Oak Ridge to show promise: UV Flourescence, Nanophosphors, and DNA based systems. Industry has also worked with the Department of Agriculture to test the practicality of such a system. We anticipate that further work will be done to develop these technologies and make them available to our industry.

We are also working with U.S. companies to address the negative effects that arise when other governments confer an unfair competitive advantage on their industries. We are doing this through the vigorous enforcement of the trade laws, and through consultations with the governments involved. Virtually all of the manufacturers that Department officials met with in the course of past six months indicated that they were prepared to compete head-on with anyone in the global marketplace; what they were not prepared to do was compete against foreign governments as well.

What we did not hear from the vast majority of the manufacturers that we met with was an interest in outright protection, whether in the form of tariffs or quotas. Rather, our manufacturers see international trade as a simple question of fairness. If we keep our markets open to our trading partners goods, they should do the same for us. But, where our trading partners' do not live up to the terms of our agreements or otherwise heed the rules, our manufacturers expect that those trading partners should pay a price.

While we are still in the process of finalizing the manufacturing report and its recommendations across many fronts, Secretary Evans has taken steps to respond to the concerns we heard from manufacturers, particularly the need for a stronger focus within the U.S. government on manufacturing and the most immediate cases of unfair trade affecting our manufacturers. The first initiative, announced by the President on Labor Day, is a new Assistant Secretary of Commerce to serve as the point person in the Administration and within the U.S. government for manufacturers and as an effective advocate for the manufacturing sector's competitiveness.

The second is the establishment of an Unfair Trade Practices Team to track, detect, and confront unfair competition before it injures an industry here at home. Many of the legal remedies available to counter unfair trade practices are costly, particularly for small- and medium-sized manufacturers. Our goal is to focus on those trading practices that are likely to have the biggest impact on our manufacturers and ensure that they are eliminated, rather than leaving small- and medium-sized manufacturers in the United States with costly trade litigation as the only possible means of addressing the unfair trade practices they face in the marketplace.

And, the third calls for the creation of an Assistant Secretary for Trade Promotion to boost our exports, particularly to those markets that our negotiators have recently opened to our trade - like China.

In addition to moving on the implementation of those recommendations, we intend to do two things to follow up. The first is to go back to the manufacturers we visited earlier this year to get their reaction to what we have suggested and to help us refine our approach as we move forward. The second is to discuss the next set of issues we intend to tackle as part of our on-going commitment to support our manufacturing sector.

Trade Relationship with China

In the more than 20 roundtables that the Department of Commerce held with manufacturers across the country during the past six months, there was no single topic that garnered more attention than our trade relationship China. The stakes involved are high. China is our fourth largest trading partner with bilateral merchandise trade reached $147.2 billion in 2002. Last year, China overtook Japan to become our third largest source of imports. In July of this year, China surpassed Mexico to become our second largest source of imports. Many have noted that our imports from China are more than five times greater than our exports, and that the bilateral trade deficit hit $103 billion in 2002 and reached $65 billion in the first seven months of this year.[1]

However, a large share of what we now import from China used to be imported from other Asian countries. China's role in the restructuring of global manufacturing is that of the final assembly point for most Asian electronic equipment destined for the United States. In other words, China becomes the exporter of record for what before would have been export to the United States from other Asian countries. What that means in practical terms is that it would be more appropriate to look at our trade account with China as an indicator of competition in manufacturing across Asia, as opposed to the rise of Chinese manufacturing alone.

There is an obvious upside to China's growth and the benefit the Chinese derive as investment in Asia shifts toward China for final assembly. That shift, together with China's economic policies, has brought about a rising standard of living in China and a considerable rise in disposable income for the average Chinese -- in turn creating -- a consumer demand that did not previously exist in China. What that means is an expanding market for goods and services, as opposed to the largely one-way street of the past. The fact that China's trade is nearly in balance overall, even though it runs a huge surplus with the United States, reinforces the point about rising consumer demand and growth in imports.

All of this makes China an attractive market for much of what we produce in the United States, including for our manufacturers. China's extraordinary economic growth – currently estimated to grow 8.6 percent this year and another 8 percent in 2004 – right now is an engine of growth for the world economy outside of the United States. What that means in trade terms is that China today represents the fastest-growing market for U.S. goods and services. Our exports to China surged by 19 percent in 2001, 15 percent last year, and by more than 20 percent in only the first 8 months of this year.

[1] Interestingly, despite the attention focused on our bilateral trade deficit with China, our bilateral trade deficit with Europe has grown more quickly in recent years than that with China and our bilateral deficit with Japan remains as high as ever. That simply tends to confirm that what we are seeing in our trade accounts is largely driven by disparities in growth that show up as lower exports to and continued high imports from slower growing economies, and stronger growth in exports to faster growing markets.

We are, moreover, far more likely to sell the sorts of capital equipment in which we have a comparative advantage in China than in most world markets based simply on the growth in the Chinese economy and the nature of that growth. If, for example, we continue to see the construction industry boom in China and a major investment in infrastructure linking the western Chinese provinces with the coast, companies like Caterpillar will find a growing market for what they sell to China. The same is true for Boeing.

Here, it is worth stressing that we need companies like Caterpillar and Boeing to succeed in the Chinese and other overseas markets because their supply chains are filled with what are known in business as tier 3 and tier 4 suppliers. Many of those suppliers are small- and medium-sized (SME) businesses that do not export directly, and the future success of these suppliers depends on whether Caterpillar and Boeing remain globally competitive.

But, it is not just the Boeings and Caterpillars of the U.S. manufacturing sector that see growth in the Chinese market as an opportunity. Direct exports by small- and medium-sized businesses in the United States have grown as well. For example, Bitrode Corporation is a Fenton, Missouri, company that manufactures equipment used by the battery manufacturing industry. Last year the company sold equipment to China to the tune of $1.5 million. The company says their exports to China are growing about 15 percent annually, while their sales in the United States are holding even at best.

Similarly, Numatics, a Highland, Michigan, company that participated in a Commerce Department trade mission in early May 2002 to China, develops and manufactures components for automated machinery used in many branches of industry, including automotive, petro-chemical, aerospace, and medical equipment. It was able to sign deals with four new distributors, each covering different geographic regions of China.

To create more small business success stories, as illustrated by Bitrode and Numatics, Secretary Evans and his counterpart at the Chinese Ministry of Commerce have agreed to discussions fostering greater participation by SMEs in our bilateral trade prior to the next meeting of the JCCT.

One of the basic reasons for negotiating for 15 years with the Chinese over their accession to the WTO was to ensure that we would knock down the many barriers to entering China's market. The situation facing our manufacturers from a competitive perspective was far worse prior to China's entry into the WTO. Our manufacturers lacked access to the Chinese market, but their manufacturers had relatively free access to ours.

Today, by virtue of the WTO, the tariff rates that China imposes on our exports are lower on average than most of the developing, and in some instances, the developed world. In addition, the WTO agreement obliges China to protect the intellectual property of U.S. manufacturers and service suppliers. The agreement also phases out many of the barriers to the free distribution of American goods throughout the Chinese economy. American goods are becoming freer to move through a variety of channels instead of being beholden to trading through a Chinese state enterprise as in the past; our manufacturers are finding new opportunities in the Chinese market.

In the first year following China's accession to the WTO, both Congress and the President showed an extraordinary amount of patience as China reviewed literally thousands of laws and regulations in an effort to make the necessary changes to bring them into compliance with WTO rules. Now, as we conclude the second year of China's participation in the WTO, we need to see actual enforcement of those laws and basic compliance with WTO rules in other areas. I know that the President, Ambassador Zoellick, Secretary Snow, and most recently Secretary Evans have all made that point vigorously with their counterparts in China. And, I can attest that, at a working level, the rest of us have taken up the cause just as vigorously.

But, there is still a very, very long way to go. And, that distance goes to the heart of the complaint many manufacturers have about China. It is the pace of the ongoing reform of the Chinese economy toward a market model, of which the implementation of the Chinese WTO obligations is a part that causes friction within our trade relationship. The WTO rules, and, indeed, the whole concept of trade are based on free competition in the marketplace. But, where one economy is organized under principles that are inconsistent with that free market model, it can cause an enormous amount of injury and friction within our trading relationships. That is the key message that Secretary Evans articulated in Beijing in October.

I recognize that many commentators see a demand for a level playing field, as a demand for protection, but that is not the case. As I said, what most U.S. manufacturers want is simply to ensure that the game is not rigged against them. That same basic maxim extends to our trade with China. We all recognize that we are far better off in a world in which the rules are observed and the competition is fair, than in a world segmented by trade barriers with less trade and slower economic growth for all. But, that depends on our trading partners, including China, complying with the rules and letting competition between companies decide the game.

The Department's Role in Trade with China

The Department of Commerce, in close coordination with the United States Trade Representative (USTR) and other agencies, has adopted an aggressive and multi-pronged approach to ensure that China honors its WTO commitments and that U.S. companies benefit from these opportunities. We will target unfair trade practices wherever they occur. We are exploring the use of new tools to expand our trade promotion activities in China. We are expanding efforts to engage Chinese officials to make sure they "get the rules right" as they continue their enormous task of restructuring their economic system.

However, keeping our focus on China's WTO implementation and the country's other trade practices is only part of the solution. We must continue to enhance the ability of U.S. businesses to compete in China. We are increasing our efforts to ensure that U.S.-developed technical standards are accepted in China just as they are throughout the world. We are launching "Doing Business in China" seminars in cities across the country to address concerns about the Chinese market from small and medium-sized businesses. We are exploring ways to develop more trade leads in China and to provide even more targeted information on opportunities in China for companies in the U.S.

Combined with these domestic efforts, we regularly engage Chinese government officials to ensure trade agreement compliance and market access for our products and services. As I mentioned earlier, Secretary Evans visited China in late October to advance U.S. interests and advocate for a level playing field in our economic relations with China. The Commerce Department is fully committed to ensuring that China comply with WTO rules, open markets, drop barriers, eliminate state subsidies and allow market forces to determine economic decisions. During the Secretary's meeting with the Ministry of Commerce in Beijing, he and his counterpart agreed to launch a dialog on China's industrial restructuring and its impact on our bilateral trade under the auspices of the JCCT. Under Secretary Aldonas met with his Chinese counterpart in Detroit last month to reinforce those points and build on their discussion in Beijing. The Secretary and the Under Secretary will have another opportunity to raise these and other outstanding issues during the JCCT to be held in Washington.

Bringing ITA into the New Global Age

This Administration understands that an aggressive trade liberalizing agenda must be accompanied by the strict enforcement of our trade laws. We understand the value of competition, and that it leads to innovation, growth, and a higher standard of living. But some of our trading partners have failed to fully embrace fair competition. While we continue to encourage the opening of new markets like China, we expect our trading partners to compete on a level playing field, and reduce practices that distort normal and fair trade relations. We must address the unfair practices that some foreign competitors use to exploit our open markets.

ITA's mission is to create economic opportunity for U.S. workers and firms by promoting international trade, opening foreign markets, ensuring compliance with our trade laws and agreements, and supporting U.S. commercial interests at home and abroad. While our mission has not changed, the world in which our domestic industries conduct their business has evolved. It is imperative that ITA makes the necessary adjustments to meet the needs of our clients.

As I said earlier, Secretary Evans is responding to the unique problems of the domestic manufacturers by calling for the Department to focus on developing strategies to make the manufacturing sector more competitive. The Secretary also wants the Department to modernize to help ensure the domestic and international competitiveness of American business.

It's been more than 20 years since the International Trade Administration (ITA) reorganized. While preparing the 2002 National Export Strategy, the Department of Commerce conducted customer surveys. The results of these surveys clarified client needs that we should be meeting by adopting best practices of other governments and private sector entities. We will focus and redeploy our resources where our clients tell us they need it most.

While the details of the ITA reorganization are still being finalized, plans call for a reduction in the number of Deputy Assistant Secretary's from 16 to 12, and sending more resources into the field so we can better serve our clients. Through reorganization, we will redistribute about 110 positions among program units.

The ITA reorganization will feature three fundamental changes to our current makeup of agencies – Import Administration, Market Access and Compliance, Trade Development, and the United States and Foreign Commercial Service. These changes will modernize our efforts and allow us to provide our clients better service. Our plans include: replacing the Trade Development unit with an Assistant Secretary for Manufacturing and Services; consolidating all trade promotion activities within the Commercial Service; and streamlining trade law administration and allocating additional resources to China.

The new Assistant Secretary for Manufacturing and Services will focus on both domestic and international aspects of U.S. industrial competitiveness. The goal will be to provide the Administration with a perspective on what is required to maintain an adequate manufacturing base in the United States. Three Deputy Assistant Secretaries will support the Assistant Secretary in implementing the mission. This new unit will promote strengthened analytic capability to focus on trends in employment and productivity, and help assess the impact of proposed domestic regulations as well as trade agreements on domestic industries.

We will move a number of industry experts into the field where they can better understand and respond to industry needs. The Assistant Secretary will work closely with an Interdepartmental Advisory Committee on Manufacturing, created to focus and coordinate all relevant departmental expertise on the problems of the manufacturing sector.

A second step in the reorganization will be to consolidate all trade promotion services within the Commercial Service. We want to put all of our programs in one place to allow for synergies between the products and more efficient delivery. This will enhance our services beyond help on particular export action. The Secretary, who serves as chair of the inter-agency Trade Promotion Coordinating Committee (TPCC), has asked the other TPCC agencies to become more responsive to their clients and adopt "best practices" used by other governments and the private sector. The Export-Import Bank and Overseas Private Investment Corporation are models on how to successfully streamline operations to focus on customer service.

This initiative will also allow us to link our advocacy efforts more directly to the domestic and overseas networks to enable early project support and post-transaction assistance. Thus responding to exporters' desire for more coordinated United States Government efforts early in the bidding process, a benefit provided to our competitors by other governments. We will also consolidate all market information, trade event planning, databases, and client management into a single location. This provides for a closer linkage to our domestic and overseas field offices for our market information centers, including the Trade Information Center, the Business Information Service for the Newly Independent States, and the Central and Eastern Europe Business Information Center.

Strengthening our domestic manufacturing sectors through enforcement of our trade laws is the final step in our reorganization plans. We will streamline trade law administration and allocate additional resources to investigate unfair trade activities in China within the Import Administration. We would also create an office devoted exclusively to China cases, so that expertise in this market can be better developed. A Deputy Assistant Secretary for Antidumping/Countervailing Duty Policy Negotiations (e.g., steel, lumber) will be created to increase our emphasis on rooting out causes of unfair trade practices. The idea is to preempt unfair trade before major damage occurs, analyzing market trends to anticipate potential problems and then consulting with other governments to address these trends.

Finally, in order to streamline and maximize current operational/human resources, ITA will eliminate overlapping and redundant product service offerings. ITA will extend its performance management program, now in place only at the highest levels, throughout the organization, thus linking individual performance to organizational goals. ITA will be able to manage human capital more strategically by better defining individual roles and responsibilities and how they support ITA's mission; build required skills and capabilities; and management knowledge and succession. All these steps will allow ITA to establish standard operating procedures throughout the organization that will help ensure meeting the needs of our customers.

These proposed changes would simplify access to information and analysis, the products and services most highly valued by ITA's customers and stakeholders, and would further create a more responsive, efficient, and accountable organization.

Import Administration Efforts

That is a quick look at what the new ITA will look like. I'd like a take a few minutes to explain what my unit, the Import Administration, is currently doing to combat unfair trade.

Since 2001, we have initiated 138 new antidumping and countervailing duty investigations, resulting in 57 new orders placed on unfairly traded imports. Examples of the most significant cases include:

- Duties up to 243.46 percent placed on imports of hot-rolled steel from ten countries after Commerce found that hot-rolled steel had been subsidized and dumped into the U.S. market.
- An antidumping duty of 135.18 percent placed on imports of refined brown aluminum oxide from China after Commerce found Chinese exporters/producers were selling their product at less than fair market value in the United States.
- Duties ranging from 20.97 to 31.23 percent placed on imports of Canadian softwood lumber imports after Commerce found that Canadian lumber had been subsidized and dumped into the U.S. market.
- Duty of 44.29 percent placed on imports of Korean semiconductors after Commerce found that production of Korean semiconductors had been subsidized.
- Duties ranging from 36.84 to 63.88 percent placed on imports of frozen fish fillets from Vietnam after Commerce found that Vietnamese frozen fish fillets had been dumped into the U.S. market.

My unit, the Import Administration will be giving priority attention to issues related to trade with China, the object of a disproportionate number of trade complaints. In fact, during the last three years, we have initiated more antidumping investigations and place more antidumping orders against China than any other country, more than twice as many as the next leading country. In 2003, more than 50 percent of all new antidumping orders put in place have been against China (6 of 11 total orders, as of Oct 6).

Our efforts do not end there. We are also more closely addressing fraud and circumvention issues in new shipper reviews than ever before. We reject one-third of all new shipper requests due to increased scrutiny of such requests and recent policy changes addressing these issues. In March 2003, we began limiting the bonding option available to new shippers to the particular producer/exporter combination that qualified for a review. In July, we implemented changes to enhance scrutiny of new shippers during the questionnaire and verification process to ensure that new shippers are legitimate entities. And last August we began collecting interest on entries imported under a new shipper bond in the event the new shipper review is rescinded.

By streamlining antidumping and countervailing duty casework, we will facilitate case specialization on critical issues. As I mentioned earlier, we are also establishing a special office devoted exclusively to cases involving Chinese imports, which will further cultivate the expertise necessary to address the unique problems encountered in that market.

The Import Administration will also house the new Unfair Trade Practices team that will report to the Deputy Assistant Secretary for Antidumping/Countervailing Duty Policy Negotiations. This new unit will strengthen ITA's ability to advance U.S. trade policies and negotiations, and address the root causes of unfair trade. As I noted earlier, the team will be analyzing market trends to identify potential unfair trade practices, and arrange consultations with governments in an attempt to preempt unfair trade cases before they arise. With regards to China, the team will closely track imports from China in 30 key sectors in order to identify unfair trade practices. We will then share this information with the U.S. industry and policy makers. Many of the legal remedies available to counter unfair trade practices are costly, particularly for small- and medium-sized manufacturers. Our goal is to focus on those unfair trading practices that are likely to have the biggest impact on our manufacturers and ensure that they are eliminated.

Conclusion

In conclusion, I want to stress that this Administration has heard the concerns of the domestic manufacturers, and we are committed to ensuring our manufacturers are given a level playing field when competing in today's global marketplace. The Department of Commerce is developing a strategy to ensure that government is fostering an environment that promotes a dynamic manufacturing industry. Part of that plan is a reorganization of the International Trade Administration that will allow us to better respond to the unique problems of the domestic manufacturers.

Thank you for giving me this opportunity to testify on this important topic. I appreciate your support for our efforts and welcome your questions.

PREPARED TESTIMONY OF
DEPUTY ASSISTANT U.S. TRADE REPRESENTATIVE
CHARLES W. FREEMAN III
BEFORE THE
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT, THE FEDERAL WORKFORCE, AND THE DISTRICT OF COLUMBIA
December 9, 2003

Mr. Chairman, Senator Durbin and Members of the Subcommittee, I appreciate the opportunity to testify today on the human capital challenges of negotiating, monitoring and enforcing U.S. trade laws and agreements, as well as these trade policy challenges as they apply to China.

Human Capital Challenges

USTR is keenly aware of the effect that an expanding trade agenda has on the agency's workloads and staffing levels. In a little more than three years, we have moved from conducting just one major negotiation to advancing seven at the same time. During this same period, our dispute caseload has risen by nearly 50 percent. These workload increases have obvious effects on USTR staff resources, and the President's requested budgets have reflected this reality, providing a 23 percent increase for USTR from FY 2002 to FY 2004.

USTR can manage the growing workloads within the President's requested budget for the agency. However, we note that the omnibus FY 2004 appropriation bill being considered by the Senate would add 16 new positions this fiscal year, of which nine would be for China-related workloads.

In addition to managing a growing workload, USTR must contend with many of the same human capital issues that other organizations face: recruitment, technical specialization, training, attrition, and retention. Human resources are USTR's greatest asset, and our ability to manage the trade agenda is dependent in part on how we manage human resources capital.

USTR has a reputation as a place where bright and energetic employees are given challenging assignments and the flexibility and tools to carry out those assignments. Because of this reputation, we have been very fortunate in attracting highly qualified candidates for job openings, and as a result have been able to quickly adapt to employee retirements and resignations. Because our network with the private sector and other Federal trade agencies with specialized missions is so strong, we have also been able to get candidates with technical, scientific or specialized job skills or language proficiency quickly. Thus, recruitment has not been a significant human capital issue for USTR.

Job retention at the agency is a human capital concern, but one that we are managing closely. Retirements and resignations from job burnout, other employment offers, or for family or other personal reasons contributes to higher employee turnover than some other government agencies. To manage this, we have in place employee counseling programs, retirement planning seminars, new training opportunities, and automation tools that allow employees to work from home on special projects, and from airlines or hotels when they are on business trips. Because we are relatively small and are able to provide more personal attention to each employee, we have not found that attrition has been a major management problem for the agency.

USTR also has a responsibility to ensure that our trade agenda is commensurate with our human capacity and budget resources. Even with bright and motivated workers, there are limits on how many new negotiations we can begin, how many country practices we can monitor, and how many trade agreements we can enforce. For that reason, each time the agency considers launching a new round of free trade agreement negotiations, we consider whether we have the resources needed to conduct the negotiations. In addition, our internal budget review processes carefully consider our resource needs in light of our trade agenda. USTR will continue to keep the practical concern of resources as a critical aspect of our evaluation of new FTAs in the next year and beyond.

U.S. Trade Policies Regarding China

This is an important subject and a matter of abiding concern to the President and Ambassador Zoellick. It is also of particular relevance this week, with Chinese Premier Wen Jiabao meeting with the President here in Washington today, and with the second anniversary of China's accession to the World Trade Organization this Thursday, December 11. China made numerous trade commitments to the United States and other WTO members upon joining the WTO, and these are set forth in China's WTO protocol of accession. While USTR is the lead agency responsible for monitoring and enforcing China's WTO commitments, it works closely with officials from the Departments of Commerce, State, Agriculture, Treasury and Labor and other agencies in Washington, Beijing and Geneva.

China acceded to the WTO on December 11, 2001, after 15 years of negotiations with the United States and other WTO members. Under the terms of its accession, China committed to implement a set of sweeping reforms designed to implement the WTO's market access, national treatment and transparency standards, to protect intellectual property rights (IPR), to limit the use of trade-distorting domestic subsidies and to make other changes to bring its legal and regulatory system in line with those of other WTO members. China viewed joining the WTO as a means to preserve and expand China's access to export markets abroad, and to promote domestic economic reforms. In turn, other WTO members envisioned that faithful WTO implementation by China would reduce the ability of non-market forces, including government policies and officials, to intervene in the market to direct or restrain trade flows.

In 2003, total U.S.-China trade is projected to top $170 billion, with imports from China exceeding U.S. exports by more than $120 billion. Two years after acceding to the WTO, China has become the United States' fourth largest trading partner. China is expected to pass Mexico as our second largest source of imports this year, and will almost certainly be the sixth largest market for U.S. exports. Imports from China are growing rapidly, and are increasingly displacing those from third country markets – including other economies in Asia, but also Mexico and other parts of Latin America. While in real terms import from China are outpacing U.S. exports to China, the growth rate of U.S. exports to China is largely in line with that of imports from China. In addition, over the last three years, while U.S. exports to the world have decreased by 9 percent, exports to China have increased by 62 percent. China has become a major consumer of U.S. manufactured exports, such as electrical machinery and numerous types of components and equipment, among other goods. China is a major importer of agricultural products from the United States, and U.S. service providers have been increasing their share of China's market in many sectors as well.

USTR Activity on China

There is no doubt, however, that China needs to be more open to U.S. goods and services. The Administration is determined to continue to address market access problems that contribute to the deficit. Our markets are certainly open to exports from Chinese companies, and we need to ensure that China operates with fair, transparent and predictable rules when it comes to our companies' access to China's market. That means, most importantly, that China must live up to the commitments that it made upon joining the WTO. We also need to ensure that China engages in fair trade when it comes to its exports to the United States. What our producers and manufacturers want, and are entitled to, is a level playing field.

The areas we have been pressing are:

- WTO implementation, including implementation of China's obligations to open its agricultural market and provide for full liberalization of trading rights and distribution services;
- Fairness in market access, such as providing for effective enforcement of intellectual property rights, lifting excessive restrictions on financial services firms, and non-discriminatory value-added tax policies;
- Fair and transparent standards and regulations, including science-based sanitary and phytosanitary measures and technology neutrality for new high technology products;
- Better cooperation on the international economic issues, including in the WTO; and
- Enforcement of U.S. trade remedies.

To achieve these goals, USTR and other agencies have engaged the Chinese from the working level all the way up to the top Chinese leadership. In some areas the Chinese have made important progress. Over the past 22 months, China has taken many positive and sometimes difficult steps to meet its WTO commitments. China has completed much of the nuts-and-bolts work of WTO implementation by reviewing thousands of laws and regulations and making necessary revisions to effect its WTO commitments, and by establishing new transparency procedures in many national and sub-national agencies. It has also reduced tariffs to their committed levels, and has begun the process of removing market access barriers affecting a wide range of goods and services sectors.

Of course, there are forces in China, as elsewhere, that are resistant to the changes wrought by WTO implementation. Despite the best of intentions by many Chinese officials, these forces have not been unsuccessful in limiting China's progress toward the goals the United States and other WTO members foresaw through China's WTO accession. As a result, China's market for U.S. goods and services is not as open as it should be, our engagement with China in the WTO has not been as useful as it should be, and China's record of WTO implementation is too fraught with inconsistencies to allow definitive statements on Chinese progress toward the rule of law.

China's potential as a market for U.S. exports of bulk agricultural commodities was a key factor in U.S. support for China's WTO accession and grant of Permanent Normal Trade Relations status to China. While bumper harvests of some crops in China in 2002 may have limited the commercial potential of some U.S. exports, China's attempts to restrict certain agricultural imports has been a recurring problem since China's WTO accession. The use of – or even the threat to use – questionable biotechnology standards and sanitary and phytosanitary (SPS) measures to restrict imports of some products for alleged health and safety concerns has frustrated efforts of U.S. agriculture traders, most notably in the case of soybeans. In the case of those bulk agricultural commodities subject to negotiated tariff-rate quotas (TRQs) in China, the setting of sub-quotas, use of burdensome import licensing procedures, allocation of TRQs in commercially unviable quantities and a lack of transparency in TRQ allocation and management have restricted what should be a ready market for U.S. exports, particularly wheat, corn and cotton.

After the efforts of Ambassador Zoellick, Agriculture Secretary Veneman and others in the Administration, the commercial impact of these potential barriers was contained. U.S. exports of soybeans topped $1.2 billion – a record – and cotton sales were already 8-10 times greater than in any previous calendar year by July 2003. In fact, as noted earlier, we are actually running a surplus with China in the agricultural area, which is projected to triple to $3.5 billion from 2002 to 2003. Chinese officials have assured us that systemic problems with both GMO and SPS regulation will be addressed, and a negotiated settlement to our concerns with China's TRQ system is in progress. However, until solutions are successfully implemented, these issues will hang like a cloud over the marketplace. These and other emerging concerns, such as China's apparent use of supports to promote agricultural exports, will require continued vigilance and engagement by the Administration in order to ensure fair competition and market access for U.S. goods.

With regard to China's future WTO implementation, the top concern of many U.S. industries involves trading rights and distribution services. These were key areas for WTO members when negotiating the terms of China's entry into the WTO. Within three years after its WTO accession, or by December 11, 2004, China agreed to make trading rights automatically available, which means that U.S. businesses will be able to import and export goods on their own, without having to use Chinese trading companies. By that same time, China also agreed to fully open up the distribution services sector, which will allow U.S. companies to sell their goods freely in China, without being required to turn the job over to Chinese wholesalers and retailers or establish a joint venture with a Chinese enterprise. In the interim, China agreed to progressively liberalize in these areas pursuant to timetables set out in its accession agreement. So far, however, while China has begun the required liberalization, it has imposed stringent conditions, which have greatly limited the number of enterprises eligible to take advantage of the intermediate liberalization. China's "go slow" approach also raises concern that China will not complete full implementation of its commitments in these areas on a timely basis. The Administration is actively engaged with China on these issues – most recently in Ambassador Zoellick's meeting with Vice Premier Wu Yi – and has made clear its views on the importance of China's full and timely implementation, both now and when full liberalization is scheduled to take place at the end of 2004.

Fairness in Market Access

In his meeting in October with Vice Premier Wu Yi, Ambassador Zoellick stressed the importance of not just predictability and consistency but also fairness in the rules governing access to China's market. Ambassador Zoellick explained that China's conspicuous failure to effectively address rampant counterfeiting and piracy greatly undermines China's credibility as a fair market. He also highlighted other fairness concerns by conveying the frustrations of many U.S. service providers with China's restrictive regulations and U.S. exporters' concerns regarding China's apparent discriminatory value-added tax (VAT) policies.

In the year leading up to WTO accession, China made significant improvements to its framework of laws and regulations protecting patents, copyrights, trademarks and other intellectual property rights. However, the lack of effective IPR enforcement in China is a major obstacle toward a meaningful system of IPR protection. IPR problems run the gamut, from rampant piracy of film and other entertainment products, to sophisticated software and semiconductor products, to counterfeiting of consumer goods, electrical equipment, automotive parts and pharmaceuticals. IPR infringements not only have an economic toll, but they also present a direct challenge to China's ability to regulate those products that have health and safety implications for China's population and international purchasers of such products. While a domestic Chinese business constituency is increasingly active in promoting IPR protection for self-interested reasons, the problem is immensely widespread. If significant improvements are to be achieved on this front, China will have to devote considerable resources and political will to this problem, and there will continue to be a need for sustained efforts from the United States and other WTO members.

In the Administration's view, the key to achieving this end will be for China to demonstrate a clear commitment to fight piracy at the highest levels, to increase deterrent-level criminal penalties for IPR violators, to show a willingness to increase prosecution and punishment of IPR offenders, to lower thresholds for criminal prosecution, to increase resources and devote more training for enforcement in all parts of China, and to establish more effective communication procedures between relevant officials of China's courts and investigative units, the Supreme People's Procuratorate and China's lawmaking bodies. Ambassador Zoellick made this point directly to Vice Premier Wu Yi in October and Deputy USTR Ambassador Josette Shiner followed up that message with senior Chinese officials in meetings in Beijing in November at the IPR Roundtable hosted by Ambassador Randt.

Fair and Transparent Standards and Regulations

One important incentive behind U.S. support for China's WTO accession was the role we foresaw WTO implementation would play in promoting transparency and the development of the rule of law in China. Indeed, in the first year of its WTO membership alone, China issued, modified or repealed more than one thousand laws and regulations to conform with WTO requirements. A China that plays by the rules of international trade promotes more accountable government and is building a transparent, open and fair regulatory environment is a China that all Americans want to see.

While China has made significant progress in revising its legal framework, other problems have persisted. In particular, China has a poor record of providing opportunities for public comment on draft laws and regulations. In addition, many of the regulatory measures that China has adopted have been issued without advance notice and, in some cases, have unfairly prejudiced foreign companies and their goods and services.

Since China's accession to the WTO, we have repeatedly engaged China on the cross-cutting need for transparency in the operation of its trade regime, as China grapples with the fundamental changes required of it. And as we have witnessed how China has been implementing its new laws and regulations, we have urged China, for example, to use only science-based SPS measures. We have also stressed the importance of regulating with technological neutrality, citing areas such as the wireless 3G field, and the need for a fairer approach in areas such as basic versus value-added telecom services and automobile industrial policy, among others. We are prepared to continue our efforts for as long as these problems persist.

U.S. Management of WTO Implementation Concerns

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

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

Enforcement of Trade Remedies Laws

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

China also agreed to two separate China-specific safeguard mechanisms to allow WTO members to cope with market disruptions caused by increasing economic integration with China. One such mechanism, the product-specific safeguard, was codified as Section 421 of the Trade Act of 1974, as amended, and is available until December 11, 2013. Since the implementation of Section 421, four petitions have been brought requesting import relief. In one case, the International Trade Commission found that our domestic producers' market had not been disrupted by imports from China. In two other cases, while the ITC found market disruption, the President determined that the adverse impact on the U.S. economy was clearly greater than the benefits from providing import relief. On December 4, the ITC found market disruption in the fourth case regarding ductile iron waterworks fittings, and the President will make a determination on import relief in early March next year. While to date no import relief has been granted under Section 421, the President, in his most recent determination, reiterated his commitment to using the safeguard when the circumstances of a particular case warrant.

The second safeguard agreed to by China as part of its WTO accession package is an additional mechanism specific to textiles, and allows WTO members under certain circumstances to invoke limited import relief – specifically a 7.5 percent (6 percent for wool products) cap on growth in imports of a given textile category for up to one year – until December 31, 2008. Last month, the Committee for Implementation of Textile Agreements (CITA) found for petitioners in response to all three of the requests that CITA reviewed. The limits on imports will go into effect as soon as the Administration formally requests consultations with the Chinese government. CITA is currently working on the specifics of that request and we expect it to be passed to the Chinese in the very near future.

Conclusion

Mr. Chairman, thank you for providing me with the opportunity to testify. I look forward to your questions.

Testimony of Franklin J. Vargo
Vice President, International Economic Affairs
National Association of Manufacturers

On Behalf of The National Association of Manufacturers

Before the Senate Subcommittee on
Oversight of Government Management, the Federal Workforce,
And the District of Columbia

Hearing On

Fair or Foul: The Challenge of Negotiating, Monitoring, and Enforcing
U.S. Trade Laws

December 9, 2003

Mr. Chairman and Members of the Committee:

I am pleased to testify today on behalf of the National Association of Manufacturers (the NAM) regarding the federal government's ability to negotiate, monitor, and enforce trade agreements. I want to commend the Chairman for scheduling this hearing, for the subject is a particularly important one in view of the changes affecting U.S. trade policy. As requested, I will focus my testimony on the implications of the trade relationship with China, the resource needs of U.S. trade negotiations, and how to get U.S. manufacturing jobs growing again.

In presenting my testimony, I would like to draw not only on my experience in the NAM and the views of many of our member companies, but also on my years at the Commerce Department, including my own role in monitoring and compliance. I would like to express particular pleasure at being able to testify before the Subcommittee along with Dr. Thomas Duesterberg, a former Assistant Secretary of Commerce who was my direct boss for several years – and one of the best bosses I ever had.

MONITORING AND ENFORCEMENT

There is little benefit in negotiating measures addressing trade barriers without ensuring that the agreements are honored and that American firms and workers obtain the benefits and opportunities intended. Trade agreement compliance cannot be taken for granted, and ensuring we get what we bargained for is important to create confidence among business, labor, and the general public that trade agreements actually work and benefit the U.S. economy.

In the last half dozen years or so the U.S. government has been devoting increasing attention to monitoring and enforcing trade agreements. An important factor behind this was the creation of the World Trade Organization (WTO) as the replacement for the previous General Agreement on Tariffs and Trade (GATT).

The WTO included, for the first time, an enforceable dispute settlement system, whereas the GATT had no enforcement ability. This had significant implications for the U.S. Trade Representative's legal office and for the other agencies, particularly Commerce and State, that provide legal and analytical assistance in developing U.S. cases for dispute settlement.

Additional factors demanding more attention to monitoring and compliance included the growth of a variety of bilateral agreements covering specific issues, the spread of bilateral investment treaties, and the rise in the U.S. trade deficit -- which led to increasing concerns that trade be conducted fairly and that other nations live up to their obligations. Largely in response, the Commerce Department created the Trade Compliance Center and then converted its entire country operation into what is now known as "Market Access and Compliance" (MAC). USTR strengthened its Enforcement Office, and understandings were reached between Commerce and USTR regarding the respective monitoring and enforcement responsibilities of each. An interagency process including the State Department and other agencies was created.

CHANGED SITUATION

The situation facing monitoring and enforcement, however, has shifted dramatically in the last year, because of two major changes in trade policy. The first is the entry of China into the WTO, and the second is the initiation of comprehensive bilateral free trade agreements. These two developments are placing very significant new demands on Commerce and USTR, with major implications on staffing and budgets.

Fortunately, both the House and the Senate authorization and appropriations committees have recognized this, and the omnibus appropriations bill now before the Senate includes the House-Senate conference report for the Commerce, Justice, and State (CJS) appropriation that contains significant added resources for both USTR and the Commerce Department's International Trade Administration (ITA). Representative Frank Wolf of Virginia, Chairman of the House Commerce, Justice, and State Appropriations Subcommittee, deserves enormous credit for his vision and tenacity in achieving this result. The NAM urges final passage of the omnibus bill this week and seeks prompt implementation by the Executive branch.

The appropriations would provide an additional $7 million to USTR, $2 million of which are expressly focused on monitoring and enforcing China's commitments under the terms of its accession to the WTO. The balance of the added resources are for the purpose of strengthening USTR's ability to negotiate the growing range of bilateral and other trade agreements.

Commerce's ITA would obtain an additional $27 million and would reorganize its functions to more clearly concentrate export promotion resources in one place and to create a new organizational structure to focus on strengthening America's vital manufacturing sector. Importantly, ITA would receive resources for creating both a Middle East Business Information Center and a China Business Information Center. We hope these will be patterned after the widely-praised Business Information Center for the Newly Independent States (of the former Soviet Union) – known as "BISNIS." Additionally, Commerce would expand its export promotion efforts in China, and as I will explain later in my statement, the NAM believes a truly massive increase in such efforts is needed.

Commerce would also focus on improving its administration of import laws related to the entry of China into the global marketplace. An Office of China Compliance would be established, and would look particularly at the needs of smaller and medium-sized U.S. firms impacted by imports from China. Such an organization is extremely important since most small U.S. firms simply cannot afford the formidable costs of bringing trade cases. Commerce would also establish a new office of enforcement within the Market Access and Compliance unit.

Mr. Chairman, the NAM was among the strongest advocates for these added resources and for a focus on China and on new trade negotiations. We believe that with these new resources, staffing levels should be adequate for now – though we want to watch the demands of new bilateral negotiations and the related enforcement needs carefully. It is important to understand that trade negotiation and enforcement resources have been inadequate for a number of years, and the added staffing and funding just brings levels up to where we need to be now. Thus we should not preclude the need for yet more resources in the not too distant future.

For example, given the complexity of issues in trade agreements and the highly technical nature of monitoring and enforcement in areas such as telecommunications, intellectual property protection, investment, etc. I could easily foresee the need for future staffing and funding increases. Moreover, the proliferation of trade agreements will place added pressures to litigate trade violations – an absolute necessity if we are to prevent further erosion of support for trade

For now, though, we believe the challenge will be to staff up quickly to the new resource levels, to adopt an aggressive stance and a pro-active approach, and to further increase interagency cooperation so as to avoid any duplication of effort among the new functions and organizations being created.

THE CHALLENGE OF CHINA

Let me, in this context, turn to the challenge of China. I want to stress that the NAM seeks a positive and balanced trade relationship with China that reflects market forces as closely as possible. The Chinese economy poses huge opportunities for U.S. exporters and investors, and these will grow rapidly. We need to nurture these opportunities as we simultaneously deal with the fact that so many import-competing U.S. firms are challenged by China as never before.

It is also important to recognize that while the rising trade imbalance with China is a growing factor affecting U.S. manufacturing production and employment, it is far from the only factor. Domestic costs, falling U.S. exports, a generalized dollar overvaluation that is only now ending, regulatory pressures, and other issues are also at work. China must not be a "scapegoat" and an excuse for not tackling the other problems. Nonetheless, the economic imbalance with China is growing so rapidly that it must be addressed quickly and vigorously.

The U.S. trade deficit with China is by far the largest in the world, standing at $103 billion last year. Its rapid growth is continuing, and the NAM expects it to be around $125 billion this year. China now accounts for close to one-third of America's total deficit in manufactured goods trade, and through mid-2003 China was accounting for 40 percent of the entire increase in U.S. manufactured goods imports from the world. The NAM hears more from its member companies about China, particularly from smaller and medium-sized companies, than all other trade issues combined.

Imports from China are six times as large as exports to China, a fact which makes correction of the bilateral deficit extremely difficult. Exhibit 1, attached to my statement, shows alternative U.S. trade balances with China in five years under various import and export growth rates. A continuation of existing trends would result in a tripling of the trade deficit, to more than $330 billion. There is no question that such a level would result in calls for wide-spread protection. We have already seen some congressional proposals for across-the-board tariffs on China, and a worsening of the trade deficit will only increase these pressures.

The NAM opposes such an approach. Protectionism must be avoided. We cannot reverse the open trading system that has been such a source of growth for the United States and the rest of the world, and risk a downward cycle of global trade deterioration. We must pursue approaches relying on market mechanisms and take actions consistent with the rules-based trade system. NAM member companies have a variety of views on China, but they all agree that the playing field has to be level and trade should follow market principles as closely as possible -- very importantly, including market-driven currencies.

CHINA'S WTO COMPLIANCE

The first step in putting our trade relationship with China on a sustainable basis has already been taken: getting China into the WTO. China's accession to the World Trade Organization in December 2001 was vital, because China has now committed to abide by the same international trade rules that apply to the United States and most other countries. For the last quarter century, we have allowed China to have open access to our market without insisting on reciprocity. The result was the trade deficit we now have.

There is no question in my mind that if China had entered the WTO (or its predecessor, the GATT) a decade ago, we would not have a deficit with China anywhere near its present size. When China entered the WTO, the United States took no market-opening steps for China, for we were already fully open. China, on the other hand, had to reduce its tariffs, start eliminating a broad range of trade barriers, and begin adhering to international trade rules such as those prohibiting subsidized exports.

Administration Placing Priority on China -- The Administration has become very aware of the challenges posed by China, and I am impressed with the extent to which they are insisting that China move more quickly in complying with trade rules. For example, when the U.S. Trade Representative, Robert Zoellick was in China this October, he said his primary message was, " ... to keep U.S. markets open, we need a two-way street, to try to expand U.S. exports to China, and operate with fair, transparent, and predictable rules." Commerce Secretary Evans was even more direct when he was in China the following week. He said, "... This trading relationship needs work – a lot of work...China is moving far too slowly in its transition to an open, market-based economy ... We have been patient, but our patience is wearing thin. The American market will not remain open to Chinese exports indefinitely if the Chinese market is not equally opened to U.S. companies and American workers."

A healthy trade relationship based on a level playing field allowing workers, farmers, and companies on both sides to compete fairly and on the basis of their respective comparative advantage is in the interest of both countries, and is what we seek.

What we are seeing now is a shifting of gears. Business and government were willing to see a "honeymoon" when China first came into the WTO at the end of 2001, but the honeymoon is over and it is time to buckle down. The trade imbalance is too large to allow the playing field to remain tilted. The Administration's determined words are very welcome, but now we must move to the next stage and begin to enforce our rights. Let me discuss some examples

Subsidized Exports? -- The NAM is receiving reports from different industries that Chinese products are being sold in the United States at prices so low they do not even cover the cost of raw materials much less than production and shipping costs. These reports suggest the possibility of widespread subsidies, either direct or indirect. Whenever Chinese companies have a genuine labor cost or other advantage under marketplace rules, that is something our companies have to deal with. But they should not have to deal with subsidized competition.

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 made-in-China pliers for 49 cents. The U.S. company makes identical pliers, but the problem is that the raw materials cost in these pliers is 61 cents. Note that this is not the sales price of the U.S. pliers -- just the cost of the raw materials before they are even processed. Since steel, plastic, and rubber prices are not lower in China than in the United States, how is it possible to take 61 cents of raw materials, process and package them, ship them across the ocean, and sell them for 49 cents?

I've mentioned only one item, but I could as easily show similar stories regarding mounting systems used to control vibration and noise on industrial machines produced by an Illinois company, brass screws produced in Ohio used in industrial equipment, commercial grade restaurant fish cookers produced in Mississippi, and many others as well. The range of products is broad and the conclusion inescapable that something is awry here. No matter how low labor costs are, it is very clear that the price of a product produced in China and shipped to the United States for sale should not be lower than the basic materials that go into that product.

Looking at the problem in another way: the average labor cost in an American manufactured good, including direct labor and benefits, is 11% of the total cost of the good. This varies by sector, but even at the high end, labor is still less than 30% of the total cost. So how is it that Chinese products imported to the United States are priced as much as 60% or 70% lower than those produced here? The Chinese still should have costs of capital, facilities, shipping, raw materials, etc. Or do they? This is the question that needs to be answered: Are there large-scale systemic forms of subsidization going on in China that make these products so cheap that our companies could not under any circumstances compete?

In order to make sure that our American manufacturers have a level playing field internationally, this issue must be addressed. Commerce's new China compliance offices should start investigating this as soon as they open their doors. Commerce Under Secretary Aldonas has said he will establish a proactive Unfair Trade Practices Team to "track, detect, and confront unfair competition before it injures an industry here at home." The pair of pliers I have mentioned today are as good a place to start as any. Commerce's investigations should include China's banking system, which is widely reported to be lending money to insolvent enterprises. Commerce Secretary Evans said in Beijing, "Non-performing loans to state-run companies are a form of government subsidy." He is absolutely right, and in addition to bank loans that do not require repayment, other situations such as free or low-cost rent in government owned or constructed facilities and subsidized raw materials and energy supplies need to be explored.

There is a particular problem here that the Subcommittee may want to explore. A 1986 court case known as "Georgetown Steel," resulted in a ruling that one could not bring subsidies cases and apply countervailing duties against products made in non-market economies. It may be time for Congress revisit this issue and to determine if it should make it plain the countervailing duty statute applies to both market and nonmarket economies – such as China.

Counterfeiting and Ineffective Enforcement of IPR Protection -- While Chinese laws on intellectual property rights (IPR) have improved considerably, the lack of effective enforcement remains a serious problem. Product counterfeiting is occurring on a massive scale, including consumer hygiene and health care products, athletic footwear, pharmaceuticals, food and beverages, motorized vehicles, aircraft parts, windshield glass, brake linings, and thousands of other products. Many of these involve unauthorized use of U.S. testing and product quality marks. The brand name reputations and export and sales abilities of American companies are being affected in the billions of dollars – with an effect on U.S. jobs as well. China needs effective laws and enforcement to criminalize counterfeiting. It also needs to enforce existing commitments to stop the export of counterfeit goods.

I have attached to my testimony just one of many examples of counterfeiting – bogus sprinkler heads that are copies of a model made by the Toro company, a well-known U.S. manufacturer and a strong member of the NAM. Exhibits 2 and 3 show the blatant Chinese copying that deceives consumers into buying an inferior product and harming the ability of U.S. companies to sell genuine products – not just in China, but around the world.

I am impressed with the U.S. government's recent actions to begin moving in this area. Ambassador Zoellick met with the Advisory Committee on Trade Policy and Negotiations (ACTPN) on this issue before his October trip to China and moved counterfeiting up to among his top priorities – as has Commerce's new Minister-Counselor for Commercial Affairs at the U.S. embassy in Beijing, Craig Allen. I want particularly to single out the new Deputy U.S. Trade Representative, Josette Shiner, for how quickly she has moved to address the counterfeiting problem in China and for the innovations she is already beginning to put in place. Anti-Counterfeiting is extremely important to NAM member companies, both large and small, and for the first time we are optimistic that the problem can really be solved.

Now that U.S. officials have emphasized to the Chinese the imperative of acting, it is necessary to obtain results from Chinese officials. It is significant that Vice-Premier Wu Yi, who is well known for her ability to achieve goals, agreed to work with Ambassador Shiner to solve some counterfeiting cases quickly and obtain visible prosecutions. We know that the Chinese government has the ability to stop the actions that it wants to stop, and the time has come to stop counterfeiting. Should this fail, there would be no alternative but to press the U.S. government to pursue our rights in the WTO.

Manipulation of VAT Taxes -- Another serious matter is an apparent WTO violation that could threaten the existence of the U.S. semiconductor industry. The Chinese government discriminates against U.S. and other non-Chinese semiconductors by assessing them with a 17 percent Value-Added Tax (VAT), while only charging a 3 percent VAT if the semiconductors are designed and made in China. A 14 percent production cost advantage conferred by tax policy is an enormous incentive to move production.

The WTO (GATT Article III (2) – embodied in the WTO) states clearly that the products of any WTO member shall not be subject to higher internal taxes in another WTO member than that member assesses on similar domestic products. Yet China's VAT discrimination has been going on for three years. This is no trivial matter, for its continuation could well result in pulling from the United States not only semiconductor production, but also research and development and ultimately global leadership in microelectronics. USTR has raised the issue on several occasions with the Chinese government. China does not appear to concur this is a violation, and we are concerned that time not be wasted on further bilateral discussions if voluntary compliance appears unlikely. Hopefully, this issue can be better understood by Chinese officials during the current visit of China's Premier to Washington. If action to come into compliance with WTO requirements does not appear imminent, however, the Subcommittee may want to explore whether this instance is an appropriate one for dispute settlement case in the WTO.

In short, then, we see a variety of unfair practices that are impeding U.S. exports to China or providing Chinese products with unfair advantages in the U.S. and global marketplace. On the other hand, China has implemented most of its required WTO changes, or at least has put laws into place – and should receive credit for that. China has cut tariffs when it was supposed to and has taken many other steps as well. The NAM recognizes that China is still in transition to a market economy and in the process of phasing in certain WTO market-opening commitments. However, because China is such an important global importer and exporter, it is vital that the United States work to ensure that China complies with all WTO obligations and particularly those that have a significant impact on U.S. economic interests.

The best approach is always a cooperative one in which both sides see their interests aligned in trade liberalization, and we want to see this spirit advanced. One positive step which could be taken would be for China to join the WTO Government Procurement Agreement (GPA). Given the huge purchasing role of the Chinese government, transparency and rules in this area could not only help improve trade between the two countries but also would set an example for further openness and liberalization in China. By joining the GPA, China would obtain the added benefit of gaining access to other WTO members' government procurement where such is open under the WTO.

Certainly joining the GPA would ensure that China did not develop a closed procurement policy. The transparency it would create would also be one of the best means of reducing corruption. Thus an open policy would benefit China as well as the United States, and we hope that the U.S. government and China will begin considering this possibility.

CHINA'S UNDERVALUED CURRENCY

One of the major factors contributing to our trade imbalance is China's undervalued and tightly controlled currency. China has maintained its currency at its 1994 level against the dollar for the last nine years -- despite a huge increase in production capability, productivity, quality, production range, foreign direct investment inflows, and other factors that would normally be expected to cause a currency to appreciate. Were it able to float, the degree of upward pressure that the yuan would feel is amply indicated in the amount of dollar reserves the Chinese government has to accumulate to prevent upward movement of its currency.

China's reserves at the end of August 2003 stood at $365 billion dollars -- 120 percent of China's annual exports and nearly one-third of China's $1.2 trillion GDP. China has added $110 billion to its dollar reserves in just the last 12 months. There are many estimates of where the currency would move if it were able to float. The NAM commends the work of Dr. Ernest Preeg, of the Manufacturers Alliance, as well as other economists' estimates – the bulk of which fall into a 20-40 undervaluation estimate. Would a considerably stronger Chinese yuan have beneficial effects? Absolutely. Many of our member companies tell us that a 20 percent or more price shift would change the competitive situation dramatically.

I want to compliment the Administration's recognition of the problem and the steps taken so far. Treasury Secretary Snow recently stated that the currency would be one of the issues discussed during the current Washington visit of the Chinese Premier. Secretary Snow said the Administration's goal is a Chinese currency whose value is determined by market forces, but that as an interim step he would be willing to see an upward valuation of the yuan to some level that more closely reflects its true exchange rate. We applaud this, and hope that Premier Wen Jiabao will understand the importance of action. China's rapid buildup of reserves are not good for the Chinese economy either, because for every dollar the Central Bank of China absorbs off the market, it is creating 8.3 new yuan -- with the consequence that China's money supply is now growing at an annual rate of nearly 25 percent. Revaluation is a win-win solution.

There is one issue the Subcommittee may want to consider in this regard. In October the Treasury testified to the House Ways and Means Committee that China is intervening "very heavily in the markets to prevent the yuan from appreciating" by buying massive amounts of dollars; but in the same month Treasury informed the Senate Banking Committee that China was not manipulating its currency as defined in Section 3004 of the Trade Act of 1988. A determination of manipulation would have initiated consultations with a view toward ending the undervaluation.

If China's huge one-way intervention in currency markets does not constitute manipulation, what does? I am certain that the Treasury followed the law scrupulously, but it strikes me that the Subcommittee may want to discuss the matter with the Treasury and other Senate committees and determine if Section 3004 is flawed and in need of amendment. This is an important question, since Treasury must report its currency manipulation findings to the Congress every six months.

CHINA AS A MARKET

Before departing the subject of China, though, let me stress again that we are seeking a market-oriented approach to U.S. - China trade that will lead to expanding benefits to the economies of both nations. It is important to avoid viewing China in a one-sided manner. In addition to being a rapidly rising supplier of imports into the U.S. market, China is also a quickly growing market for foreign goods and services, and this must not be overlooked. Last year China was our fastest-growing export market. While our overall exports fell 5 percent, our exports to China were up 15 percent. Only 8 percent of China's imports come from the United States. The European Union sells considerably more to China than we do. We need to examine why the U.S. has such a small share of China's import market, and what -- in addition to a currency shift -- U.S. exporters need to do to change this situation and help boost two-way trade.

Exporting is not the only way American companies sell abroad. In fact, investing overseas to produce in markets abroad is the predominant way that American companies compete around the globe. These investments strengthen the competitive ability of American firms globally and allow them to increase their market position in countries all around the world. Less than 5 percent of U.S. global foreign direct investment in manufacturing is going to China. About 90 percent goes to Europe and other high-wage countries. Commerce Department data show that the bulk of the output of U.S. firms in China is sold in the local Chinese market. Commerce's data imply that only three percent of U.S. imports from China came from U.S. manufacturing affiliates there.

Overwhelmingly our imports from China come from Chinese, or at least non-U.S., companies. Nevertheless, it is certainly true that more U.S. companies are beginning to consider moving to China to stay globally competitive. The best way to ensure that investment flows follow economic fundamentals while maintaining growing manufacturing production in the United States is to have market-determined currencies and a better investment environment in the United States.

I want to conclude my China discussion by stressing that the NAM believes we must undertake a massive joint public-private export trade effort to increase U.S. exports to China. We believe that very rapid rates of U.S. export growth to China are possible – rates of 25-33 percent annually. We believe the time has come for a total revamping of the U.S. government's export promotion efforts in China. The stage is set. The House-Senate appropriations language calls for a huge increase in attention to China export promotion, including the development of American Trade Centers.

With China's market opening moves stemming from its WTO obligations, restoration of reasonable exchanges rates vis a vis our major competitors, and what we hope will be a Chinese currency that reflects a reasonable market valuation, U.S. export are set to boom. But they will not do so on their own. The Chinese market is too distant and unfamiliar to most U.S. companies, and they need a partnership with the U.S. government – and particularly the Commerce Department. We hope the Chinese government would work toward this goal as well.

NEGOTIATING AND ENFORCING TRADE AGREEMENTS

Let me now turn to the other new factor impacting Commerce and USTR trade resources: negotiating trade agreements. The need for these agreements is startlingly clear once one takes a look at Exhibit 4, attached to my statement. This exhibit shows the WTO bound tariff rates for various categories of manufactured goods maintained by most of the world's significant trading nations. What leaps off the page is how low our tariffs are and how high the tariffs are in many other countries. This is what we mean by the "unlevel playing field", and it is one of the reasons that our imports have tended to grow more rapidly than our exports over time. We have to get foreign barriers down to our level.

Until recently, the United States had very few free trade agreements – three, to be exact: the U.S.- Canada free trade agreement, the agreement creating the North American Free Trade Area (NAFTA), and the small and rather simple U.S. – Israel Free Trade Agreement. Other countries and trading areas, however, had been developing a proliferation of free trade agreements putting U.S. exporters at a disadvantage in many parts of the world.

The U.S. trade philosophy changed and with the passage of Trade Promotion Authority, the United States now has trade agreements with Chile, Jordan, and Singapore; and is negotiating with, or has announced an intention to negotiate with Australia, Bahrain, Bolivia, Colombia, Costa Rica, El Salvador, the Dominican Republic, Ecuador, Guatemala, Honduras, Morocco, Nicaragua, Panama, Peru, the Southern African Customs Union, and Thailand. And this is on top of the Doha Round of WTO negotiations and the Free Trade of the Americas (FTAA) negotiations.

That is a *huge* workload! The NAM supports those free trade agreements, and actually would like to see more. While we would like to see these barriers negotiated away globally in the WTO, we cannot put all our eggs in that basket. To date we have seen little willingness on the part of developing countries to make substantial trade barrier cuts in WTO negotiations. While we want U.S. negotiators to continue pressing vigorously, we need simultaneously to pursue regional and bilateral approaches.

The negotiation requirements are quite sizeable. Teams of 50 or more U.S. negotiators from USTR, Commerce, and other agencies are needed as the details of tariff negotiations, intellectual property, customs, investment rules, government procurement, services, and many other aspects that go into a state-of-the-art negotiation proceed. Negotiating resources are already strained, and the ambitious schedule of negotiations is likely to stretch them even more. The expanded appropriation in the omnibus legislation will certainly help, but it may well develop that more will be needed.

The other resource implication of free trade agreements is that their dispute settlement procedures require significant time inputs on the part of the U.S. government. Each of the bilateral agreements has its own dispute settlement processes that require the time of compliance specialists and trade litigators. Certainly it is our expectation that trade cases under these agreements will be the exception, not the rule. The NAM fully believes that, overwhelmingly our trading partners enter into trade agreements with the expectation that they will live up to their obligations. Nonetheless, there will always be disagreements, differences of interpretation, and the like; and these will inevitably lead to trade disputes.

Given the existence of a dozen or more individual free trade agreements, monitoring and enforcement becomes a complex exercise – one that could well need added resources. While I think we are a way off from the first cases, it is not too soon for the Administration to begin designing the mechanism for dealing with these and to begin working with the Congress to consider whether added resources will be needed.

REVITALIZING MANUFACTURING AND JOBS

As the final topic of my testimony today, let me address U.S. manufacturing jobs. Manufacturing went into recession in 2000 and only now – three years later – is showing signs of a turnaround. Shipments of manufactured goods have fallen an astonishing $270 billion since 2000, and 2.8 million American factory jobs have been lost – about 15 percent, or roughly one in every six jobs. Manufacturing represents 14 percent of the American workforce, but has accounted for nearly 90 percent of all the job losses since total U.S. employment peaked in March 2001.

With the tax cuts that have been enacted, low interest rates, and appreciation of major foreign currencies from their previously highly-undervalued positions, the stage is now set for a turnaround in manufacturing. However, despite recent promising signs that the manufacturing sector is recovering from its three-year long recession, U.S. manufacturers continue to struggle in the face of weak demand and the most intense global competition in history. The NAM is pleased with the rising level of awareness on the part of the Administration and the Congress with respect to the need to revitalize manufacturing. Commerce Secretary Evans is expected to release the Administration's analysis of manufacturing and his recommendations for revitalization soon, and we are looking forward to a robust report with strong, actionable recommendations.

In looking at why the manufacturing recession is so sharp and why the sector is behaving differently from the rest of the economy, trade immediately stands out as a huge factor. Of the $270 billion drop in U.S. manufactured goods shipments since 2000 (through July 2003, at an annualized rate), $80 billion stems from a drop in U.S. manufactured goods exports -- accounting for roughly one-third of the fall in production. A one percent increase in import penetration of manufactured goods over that time accounted for a further $40 billion of the production decline, about 15 percent. All of the increase in import penetration came from China. Import penetration from the rest of the world has been flat since 2000 -- meaning U.S. imports from them grew no faster than U.S. consumption.

Thus, changes in exports and imports – predominantly the drop in exports – may account for close to half of the fall in U.S. manufacturing production. The other half must be attributed to the domestic economy. We are optimistic that the tax changes, the rundown of inventories, the need to begin expanding purchases of capital goods, and continued low interest rates already have the domestic economy turning around. Certainly the third quarter GDP growth, while not sustainable at that level, gives us great encouragement.

Fixing the trade half of the situation is something that is also underway. The fundamental cause of our trade difficulties has been the extreme run-up in the value of the U.S. dollar since 1997. At its peak the dollar rose about 25 percent over its early 1997 level according to the Federal Reserve Board's (FRB) trade-weighted broad currency index. Using the Institute for International Economics' rule of thumb that each one percent change in the value of the dollar leads to a $10 billion shift in the trade balance, the appreciation of the dollar could account for about $250 billion of the $350 billion increase in the deficit -- or about 70 percent.

With the restoration of the dollar to normal levels vis-a-vis major currencies such as the euro, the stage is set for U.S. export growth and moderation of import penetration. It is important to understand that the dollar is not "weak" or undervalued – just back to where it was before the trade deficit began to erupt. For example, last week the euro reached a value of $1.20; but this amount is barely at the level of the 1990's, when the currencies comprising the euro were worth an average of $1.21 -- and at times were nearly at a level of $1.40.

The remaining currency problem is in the Asian currencies that are being prevented from appreciating by heavy intervention in currency markets. Together, four Asian economies -- China, Japan, South Korea, and Taiwan -- hold $1.2 trillion of official reserves, up $600 billion in the last four years and up $250 billion in just the last 12 months as they have purchased dollars to prevent an excess supply of dollars from lowering the value of their currencies.

It should be pointed out that these four countries account for 60 percent of the entire global U.S. trade deficit in manufactured goods. China holds the key, for all the other Asian nations keep looking over their shoulders at China and its low export prices.

In addition to getting currencies back into line, we must also level the playing field by getting foreign tariffs and trade barriers down to our level, and this is where an aggressive trade negotiation program comes into play. The longer we wait, the more we will fall behind, which is why we should ensure that the necessary resources are available for the robust package of agreements we must have.

Most importantly of all, however, the United States must act on reducing the cost of producing in the U.S. by containing health care costs, enacting legal reforms, including asbestos litigation reform, ensuring adequate and affordable energy supplies, and reforming the regulatory process.

This is really the central issue. We will not succeed in preventing the migration of our manufacturing base if we do not address the high cost of manufacturing in the United States. It is that simple. U.S. industry is burdened by legal and regulatory systems that retard growth and destroy jobs. Unrestrained asbestos liability alone, for example, could cost U.S. industry $250 billion, resulting in the bankruptcy of even large corporations. Rapidly rising health care costs are a constant worry, particularly for small manufacturers. Uncertainty over sources of energy supply has led to price volatility. Lack of support for research and development threatens to undermine U.S. technology leadership. And shortages of skilled workers have many manufacturers wondering how they can expand in the future.

The National Association of Manufacturers and the Manufacturers Alliance jointly released a study this morning delving into the implications of these domestically-imposed costs. The combined magnitude of these domestic cost factors is staggering and goes a long way to explaining why manufacturing in America is at risk. Together, the various cost factors combine to create at least a 22 percent cost disadvantage to producing in the United States rather than abroad. Dr. Duesterberg and I have copies for the Subcommittee, and our organizations will ensure every member of the House and Senate receives a copy of this "must read" report.

Unless these cost challenges are addressed, frankly we can expect a growing erosion in the U.S. industrial base. Competition from China will only accelerate the trend. However, if we begin to act now, with both a refocused and positive trade policy toward China, an aggressive program of trade agreements, and a concerted strategy on economic growth and manufacturing renewal, we can restore the dynamism and competitiveness of U.S. industry and ensure the global leadership that is so central to our economic and national security.

Thank you, Mr. Chairman.

EXHIBIT 1

ALTERNATIVE U.S. TRADE DEFICITS WITH CHINA

20-Year Trend: Exports to china up 12% per year; Imports up 20% per year

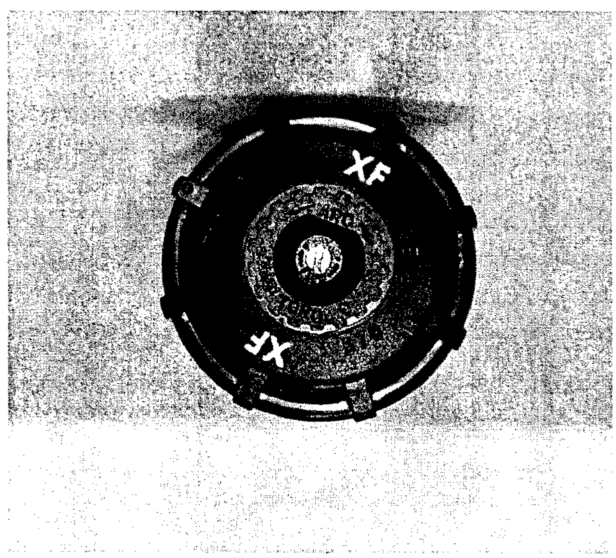
IF THESE TRENDS CONTINUE FOR 5 MORE YEARS THE CHINA TRADE DEFICIT WILL TRIPLE, TO $330 BILLION

Projected 2008 Trade Deficits with China
Under Alternative Export and Import Growth Rates
(Billions of Dollars)

Import% \ Export%	12%	25%	33%
20%	($330)	($290)	($252)
15%	($246)	($205)	($167)
10%	($178)	($138)	($100)
7%	($144)	($104)	($66)

EXHIBIT 2

GENUINE TORO SPRINKLER HEAD – TOP VIEW



FAKE TORO SPRINKLER HEAD – TOP VIEW

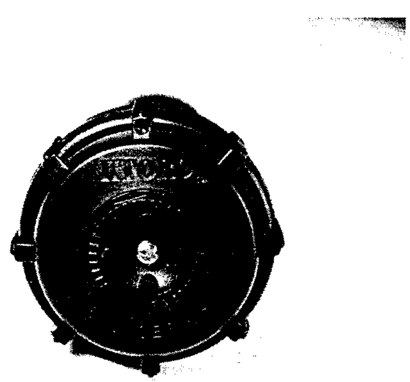
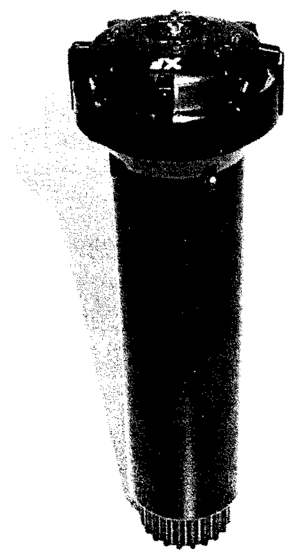


EXHIBIT 3

GENUINE TORO SPRINKLER HEAD – SIDE VIEW



FAKE TORO SPRINKLER HEAD – SIDE VIEW

Attachment: Excerpt from WTO Special Study: Market Access: Unfinished Business

Table II.2. Bound tariffs on industrial products. Simple averages by country and MTN category
(Percentage)

Import markets	1 Wood, pulp, paper and furniture	2 Textiles and clothing	3 Leather, rubber, footwear and travel goods	4 Metals	5 Chemicals and photo-graphic supplies	6 Transport equipment	7 Non-electric machinery	8 Electric machinery	9 Mineral products and precious stones and precious metals	10 Manufactured articles not elsewhere specified	11 Fish and fish products
North America											
Canada	1.3	12.4	7.6	2.8	4.5	6.8	3.6	5.2	3.1	4.2	1.8
United States	0.6	8.9	8.4	1.8	3.7	2.7	1.2	2.1	3.3	3.0	2.2
Latin America											
Argentina	29.4	35.0	35.0	34.4	23.5	34.6	34.9	34.7	32.8	33.7	34.5
Brazil	27.7	34.9	34.7	33.4	22.7	33.6	32.6	31.9	33.5	33.5	33.4
Chile	25.0	25.0	25.0	25.0	25.0	24.9	25.0	25.0	24.9	25.0	25.0
Colombia	35.0	36.8	35.2	35.0	35.0	35.8	35.0	35.0	35.1	35.0	47.7
Costa Rica	44.2	45.1	45.9	44.5	43.5	49.6	44.2	43.3	44.6	44.7	46.3
El Salvador	35.3	38.6	40.8	35.0	37.7	35.8	32.6	34.6	37.7	38.2	45.0
Jamaica	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.6
Mexico	34.0	35.0	34.8	34.7	35.2	35.8	35.0	34.1	34.4	34.6	35.0
Peru	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0
Venezuela	33.7	34.9	34.5	33.6	34.1	33.6	33.2	33.9	34.1	33.4	33.8
Western Europe											
European Union	0.7	7.9	4.8	1.6	4.8	4.7	1.8	3.3	2.4	2.7	11.8
Iceland	11.9	9.7	13.8	6.8	2.8	17.1	7.0	19.4	11.5	21.9	3.6
Norway	0.4	8.5	2.2	1.1	3.0	3.3	2.7	2.7	0.7	2.2	7.3
Switzerland	2.1	4.6	2.0	1.1	1.5	2.2	0.6	0.7	1.5	1.3	0.5
Turkey	40.5	80.3	79.9	30.4	29.0	25.8	23.7	26.6	39.4	43.3	26.2
Eastern Europe											
Czech Republic	5.5	6.2	3.8	3.8	4.0	6.2	3.8	4.2	3.4	3.6	0.2
Hungary	5.4	8.1	6.7	4.9	5.5	15.9	8.4	9.5	5.0	7.8	17.1
Poland	8.0	13.1	11.9	9.9	8.7	16.1	8.9	9.7	6.9	11.6	16.3
Romania	31.4	32.9	30.7	31.7	30.6	32.1	29.5	27.3	32.2	29.3	28.1
Slovak Republic	5.5	6.2	3.8	3.8	4.0	6.2	3.8	4.2	3.4	3.6	0.2
Asia											
Australia	7.0	28.8	17.5	4.5	9.2	15.1	9.1	13.3	7.0	7.0	0.8
Hong Kong, China	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
India	56.4	87.8	67.8	58.3	44.1	53.9	36.2	44.8	47.2	72.4	68.6
Indonesia	39.6	39.9	39.6	36.4	37.4	58.5	36.6	38.7	39.2	36.9	40.0
Japan	1.2	6.8	15.7	0.9	2.4	0.0	0.0	0.2	1.0	1.1	6.2
Korea, Republic of	4.8	18.2	16.7	7.7	6.7	24.6	11.1	16.1	10.4	11.4	19.1
Macau, China	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Malaysia	19.8	20.7	19.1	14.2	15.4	29.8	10.9	14.1	14.7	12.6	14.5
New Zealand	4.5	21.9	19.1	11.2	6.1	17.0	15.1	16.1	7.6	11.7	2.8
Philippines	31.8	27.7	32.7	22.9	22.6	26.1	22.0	26.2	28.5	29.5	29.4
Singapore	3.1	7.8	3.4	3.2	5.0	4.4	4.3	4.9	1.2	1.2	9.8
Sri Lanka	32.6	45.0	43.0	16.6	15.8	18.3	12.8	20.4	26.2	27.1	49.2
Thailand	21.3	29.2	34.1	25.6	29.3	38.5	23.4	30.5	25.9	29.5	12.5
Africa											
Cameroon	21.8	22.8	21.2	15.9	11.6	14.9	12.2	16.8	18.5	22.9	23.8
Chad	21.8	22.7	21.2	15.9	11.6	20.2	12.2	16.8	18.5	22.9	23.8
Gabon	15.5	15.1	15.0	15.2	15.2	15.0	15.2	15.0	16.1	18.5	15.0
Senegal	17.6	16.1	16.3	15.1	15.2	14.1	6.7	7.2	15.1	15.0	12.9
South Africa	9.2	27.7	23.1	14.1	13.9	23.3	12.0	17.4	11.5	14.8	22.5
Tunisia	34.2	56.3	36.1	25.6	26.5	25.5	25.2	29.1	28.9	32.5	41.2
Zimbabwe	12.6	21.4	13.1	9.1	5.5	10.1	6.3	12.3	7.6	15.5	3.1

Source: WTO IDB, Loose Leaf Schedule and national custom tariffs. See Technical notes to this chapter for more details.

Manufacturers Alliance/MAPI
Knowledge · Solutions · Results · 1933

Testimony of
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Manufacturers Alliance/MAPI
Before the
Subcommittee on Oversight of Government Management,
the Federal Workforce, and the District of Columbia
Committee on Governmental Affairs
United States Senate
December 9, 2003

Fair or Foul: The Challenge of Negotiating, Monitoring, and Enforcing U.S. Trade Laws

(With Additional Views on the State of the Manufacturing Sector and Policies To Address its Current Challenges)

Mr. Chairman and Members of the Committee, I want to thank you for holding this hearing on a subject of vital and timely importance to U.S. manufacturers. My organization represents over 400 leading manufacturing firms whose products range from basic materials to advanced manufacturing and leading-edge technology and associated services. The Alliance itself is primarily a research and executive education provider, but we do advocate public policies benefiting our member companies. Notwithstanding the support of our member companies, the views I will present today are mine alone and do not necessarily represent the unanimous opinion of our members.

I. The Importance of Manufacturing to the Domestic Economy

The subject of the hearing today is of vital importance to manufacturers for the simple reason that this sector is much more engaged in the global economy than the much larger services sector. When adding together both exports and imports of manufactured goods, the total equals 40 percent of total output in this sector, compared to just 6 percent for the rest of the economy. This proportion has doubled for the manufacturing sector since 1987. Altogether, manufacturing is about six times more engaged in global markets than the rest of the economy.[1] Over two-thirds of all U.S. exports are manufactured goods. U.S. manufacturing exports have more than doubled since 1990, but so have imports. As a result, over 80 percent of the U.S. trade deficit is in manufactured goods and that trade deficit is approaching 5 percent of gross domestic product (GDP) in the United States. In this context, secure, transparent, fair, and enforceable access to foreign markets is vital to the health of this sector.

Today I want to focus on what we think are the sources of strength in U.S. manufacturing, and then on some ways, including negotiating and enforcing trade agreements, the federal government

[1] This and other useful data about manufacturing can be found in The Manufacturing Institute, *The Facts About Modern Manufacturing* (Washington, DC: The Manufacturing Institute, 2003).

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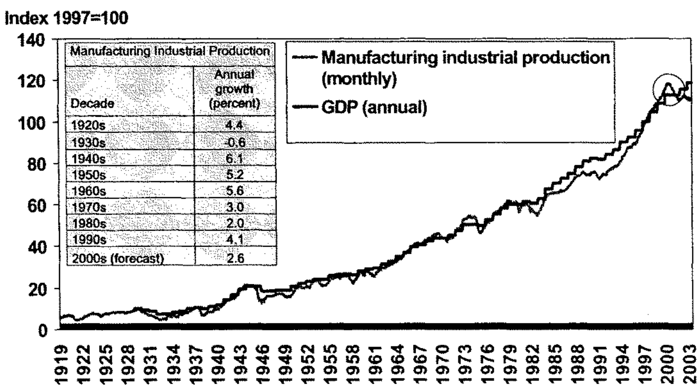
can play a constructive role in supporting the core strengths of this sector. Before turning to this discussion, I want to say a few words about the importance of manufacturing to the health of the domestic economy.

In many ways which became abundantly clear during the strong economy of the late 1990s, U.S. manufacturing remains the most important engine for growth in the United States—and indeed the global—economy.[2] Despite the prevailing view that this sector is in a state of irreversible decline, the quantity of manufactured output has grown about as fast as the rest of the economy for at least the last 80 years, as Chart 1 shows. In the 1990s, it grew ***faster*** than the rest of the economy. Moreover, this sector drives growth throughout the economy in a number of important ways.[3]

In the first place, producing a manufactured good requires more inputs, investment, transportation, and other services than for other sectors. According to the U.S. Department of Commerce, for every one dollar in sales of manufactured goods, another $1.43 in demand for intermediate products and services is generated. This compares to $1.22 for raw material extraction, 90 cents for transportation and utilities, 70 cents for health and education services, and 50 cents for financial and business services. All told, in the 1992-2000 expansion, manufacturing accounted for 22 percent of growth, even though it represents only 15-17 percent of value added in the economy.

Chart 1
Manufacturing Closely Linked to the Economy:
Report of Its Demise Is Premature



Source: Federal Reserve Board

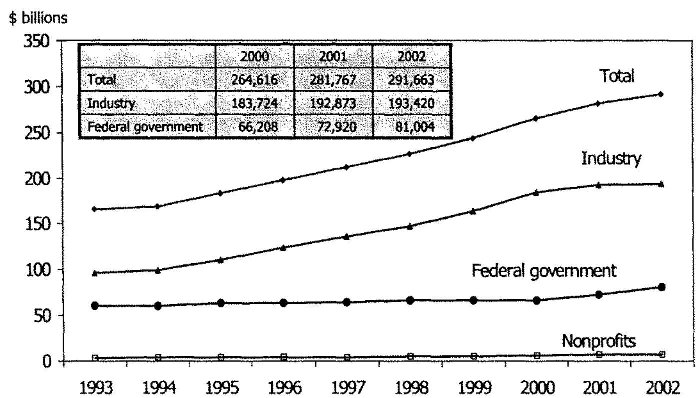
More importantly, the manufacturing sector is a primary source of innovation and productivity growth in our economy. Manufacturing accounts for over 90 percent of new patent approvals in the United States. Thanks to a strong commitment to research and development (R&D), efficient allocation of capital to new products, and an openness to change, it has been able to turn patents and research into money-making products valued around the world. Chart 2 shows the sources of R&D expenditures in the last decade. Two-thirds of R&D is now provided by private industry, a reversal

[2] We have developed this view at length in Thomas J. Duesterberg and Ernest H. Preeg, eds., *U.S. Manufacturing: The Engine for Growth in a Global Economy* (Westport, CT: Praeger Publishers, 2003).

[3] A good summary of this argument can be found in Joel Popkin: *Securing America's Future: The Case for a Strong Manufacturing Base* (Washington, DC: NAM Council of Manufacturing Associations, 2003).

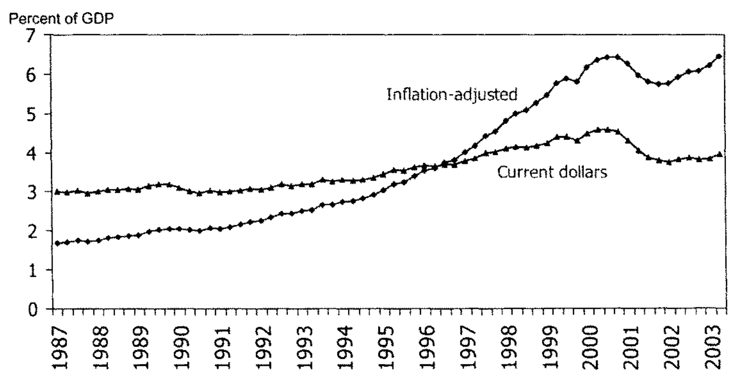
from the 1960s when government provided nearly two-thirds of funds for this purpose. Another important development is the growing use of information technology (IT) throughout the economy. Chart 3 shows that investment in IT, including communications, is growing stronger as a share of the economy, especially when measured in real terms to reflect quality improvements.

Chart 2
National Expenditures for R&D, 1993-2003



Source: National Science Foundation/Division of Science Resources Statistics

Chart 3
High Tech Investment is a Growing Share of the Economy



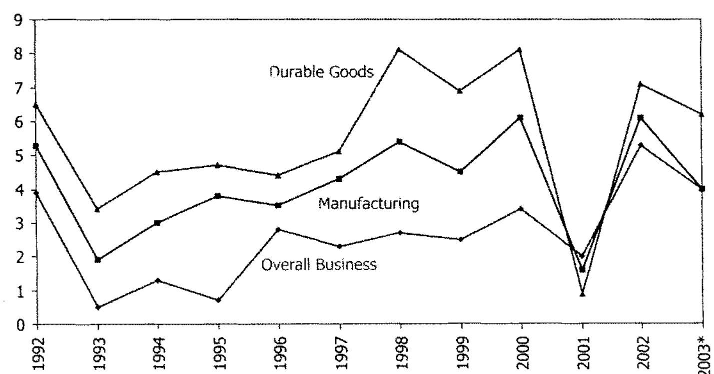
Source: U.S. Department of Commerce, Bureau of Economic Analysis

The use of IT has been shown to be a primary ingredient in enhancing productivity. The development and integration of IT products into the design of products, their production and maintenance, and into the services chain has been pioneered in the manufacturing sector. The commitment to research and innovation, and the widespread adoption of IT equipment and the associated communications networks it engenders, drives improvements in productivity.[4] Data (as shown in Chart 4) for the past ten years confirms that the remarkable renaissance in productivity is led by the manufacturing sector, especially the durable goods sector which is the heart of American manufacturing. In contrast, it is primarily the commodity-type production of consumer goods which has moved abroad.

Moreover, the productivity boom pioneered by the manufacturing sector is now spreading to the services sector. The IT equipment invested and integrated into production processes for goods is now being effectively adopted by associated industries such as wholesale and retail trade and transportation. Manufacturers often drive this process through such management innovations as lean manufacturing, which has in turn driven the development of demand-driven supply chains. Through these processes the customer is linked to producers and their supplies with real-time communications and tracking systems. Flexible manufacturing systems now permit retailers increasingly to customize production for things as diverse as jeans, cell phones, computers, and automobiles. The diversity and choice now enjoyed by consumers is unthinkable without the automated production systems, integrated supply chains, and real-time communications pioneered in the manufacturing sector.

Manufacturers are also increasingly using new technologies and associated management systems to assist customers in various ways that involve "services." Manufacturers are, in effect, becoming "solution providers" by integrating goods production with enterprise planning, supply chain integration, maintenance, and other related services. Better integration of the products and services sectors helps create more value and efficiency throughout the economy.

Chart 4
U.S. Productivity Growth, 1992-2003
(percent growth, year over year)



* First three quarters, 2003
Source: U.S. Department of Labor

[4] For a review of these linkages, see Jeremy Leonard, *The 1990s Productivity Acceleration Is Here to Stay* (Arlington, VA: Manufacturers Alliance/MAPI, 2003), Economic Report 556e, June 23, 2003.

Not only is innovation becoming a driver of growth in the modern American economy, but economists are increasingly emphasizing the substantial spillover effects of a vibrant, research-driven innovation machine.[5] Spillover benefits can come from firms using new products in innovative production techniques pioneered by other firms, from knowledge gained in one sector or product that can be used in others, and from "network spillovers" where "R&D benefits are enhanced in value by the development of a related set of technologies," such as occurred in the telecommunications industry with the advent of the Internet.[6] These spillover effects of course are magnified when the R&D and the firms that develop related new products and production processes are in close geographic proximity. Michael Jensen is well known for elaborating this theme through his work on "clusters," such as Silicon Valley, the biomedical research and development areas around Boston and Washington, and the automotive and machinery cluster in the upper Midwest.[7] Importantly for our purposes today, economic research also tends to corroborate the insight that production benefits from proximity to research, and vice versa.[8] This suggests that maintaining a strong, domestic research base is one key ingredient in sustaining domestic production.

The National Science Foundation (NSF) notes three main reasons culled from economic research showing that high-technology industries are important to any nation.[9] Research-intensive firms lead in innovation, allowing them to capture the benefits of first movers, especially when protected by patents, copyrights, trademarks, or other intellectual property protections. Innovative firms tend to use resources more productively as well. Second, technology-driven firms develop the types of high value added products which ". . . are successful in foreign markets . . ." and support higher levels of pay for employees. Finally, industrial R&D benefits other sectors, such as financial services, transportation, and wholesale and retail trade, by perfecting products and processes which enhance productivity and create new jobs.

Finally, manufacturing jobs on average pay more than the average in the private sector and generate good jobs for both highly educated and technically educated workers. The remarkable dynamism of manufacturing pays dividends to the entire society through productivity gains and the lower prices which are the result of these advances. Chart 5 gives some recent data showing that the higher level of manufacturing wages has continued even in the recent double-dip manufacturing recession, which was the most severe in this sector since the Great Depression.

[5] See William Baumol, *The Free Market Innovation Machine* (Princeton, NJ: Princeton University Press, 2002).

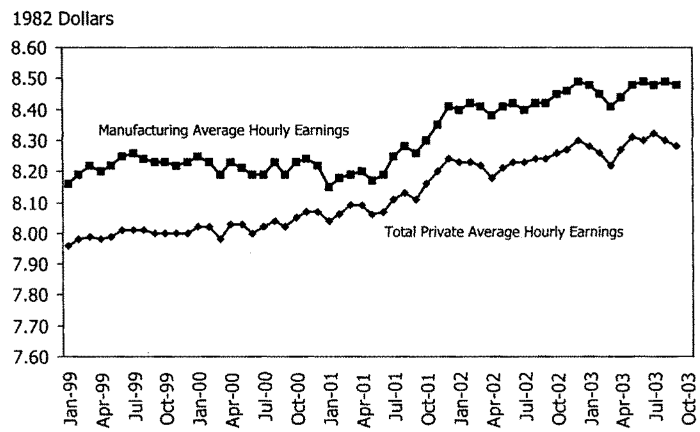
[6] See Popkin, *op. cit.*, pp. 12-14.

[7] Michael Jensen, *The Competitive Advantage of Nations* (New York, NY: The Free Press, 1990).

[8] Popkin, *op. cit.*, pp. 13-14.

[9] National Science Foundation, *Science and Engineering Indicators—2002* (Arlington, VA: National Science Foundation, 2002), Vol. I, p. 6-5.

Chart 5
Manufacturing and Total Private Average Hourly Earnings
(in 1982 dollars)



Source: U.S. Department of Labor, Bureau of Labor Statistics

The dynamics of a research-driven, innovative, productive, and highly flexible model has allowed American manufacturing to remain globally competitive in increasingly tough international markets. American exporters actually increased their share of world goods trade in the 1990s, especially in the area of products with a high degree of embedded technology. The American advantage based on technology and productivity is enhanced by socio-political factors such as a stable rule of law, a flexible labor force, creative and efficient financial markets, and a general openness to change, factors that are not found to such a degree in major competitors such as Japan, China, Korea, and the European Union. The element of flexibility is especially important in an age of innovation, where life cycles in sectors like electronics, medical products, communications, and consumer durables are very fast. Until the global downturn of 2001, and the peak of the recent strong dollar era in 2001 and 2002, the United States enjoyed a trade surplus in advanced technology products. In 1997, the United States enjoyed a trade surplus of over $32 billion in advanced technology products such as aerospace, IT, biotechnology, medical products, advanced chemicals, electronics, automation equipment, and advanced materials.[10] Chart 6 shows the growth of trade in high-technology products in the 1980s and 1990s compared to competing nations. Clearly the United States performed well in this period. The proportion of "R&D intensive" goods among U.S. exports grew from around 20 percent in 1980 to around 35 percent 20 years later.[11] Clearly, the United States was the outstanding global performer. While many labor-intensive industries were moved offshore, those embodying advanced technologies, difficult production processes, complex systems integration, and substantial capital requirements increasingly were becoming the core strength of the domestic manufacturing sector.

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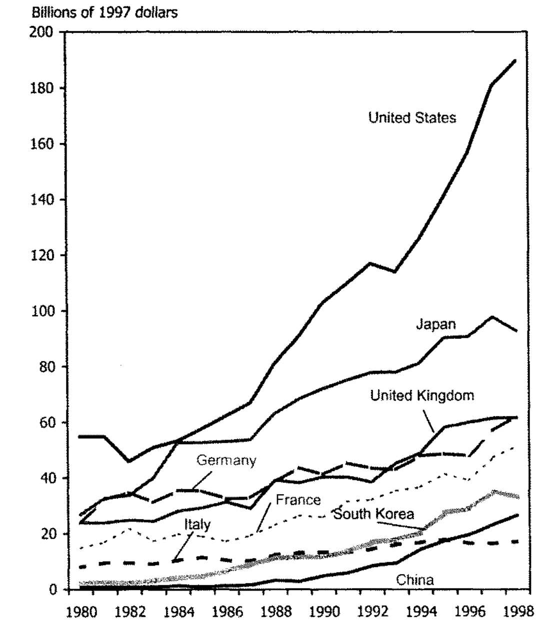
[10] This figure is taken from data collected by the National Science Foundation, definition of "advanced technology products." See National Science Foundation, *Science and Engineering Indicators—2002, op. cit.*, pp. A6-21 to A6-29.

[11] Calculated from U.S. Department of Commerce, Bureau of Economic Analysis data.

Chart 6
High-Tech Exports, 1980-1998



Source: National Science Foundation, *Science and Engineering Indicators—2002*

The trade performance of the advanced technology goods sector has deteriorated since the late 1990s. We project a trade deficit of more than $25 billion this year in this sector. Most of this deficit is, not surprisingly, with Asian nations. In 2002, we lost over 500,000 jobs in high-technology industries and over 300,000 in related service industries such as computer programming.[12] Unfortunately, neither the Department of Commerce nor the National Science Foundation maintains up-to-date, disaggregated statistics on these trends, so we are unable to analyze with any precision the areas where high-technology trade performance has faltered. Given the centrality of this sector to the economy, it would be worthwhile to improve our analytic ability by providing much more timely data. This need also extends to the research and education data discussed in the next section.

II. Challenges to U.S. Manufacturing Competitiveness

The combination of the end of the Internet-related boom, a very strong dollar, the rise of China and India as major competitors, and increased cost pressures on U.S. producers has raised doubts regarding the continued strength of domestic-based manufacturing. While economic cycles cannot be eliminated and the entry of new competitors into the market is inevitable, the issues of cost

[12] American Electronics Association, *Cyberstates, 2003* (press release of November 19, 2003).

pressures and an overvalued currency can be addressed by appropriate policy. Together with the National Association of Manufacturers (NAM), the Alliance released a paper this week on the cost squeeze affecting manufacturers.[13] We found that a combination of cost pressures from excessive litigation, high corporate taxes, high natural gas costs, excessive growth in health care and pension costs and excessive regulatory costs added over 22 percent to core unit labor costs relative to the nine major international competitors to the United States. Table 1, taken from our new study, shows that most of the excessive overhead costs stem from higher corporate taxes and employer-paid benefits and excessive tort and regulatory burdens. These additional costs more than offset the gains made by U.S. manufacturers over the past two decades in unit labor costs relative to our major competitors. (Chart 7 shows that U.S. unit labor costs have declined by about 10 percent over this time relative to competitors, largely thanks to productivity gains.) Such a cost burden is exacerbated by the problem of competing with many East Asian industrial giants (China, Japan, Korea, and Taiwan) which artificially lower the value of their currencies in global markets,[14] and must be addressed for the long-term health of U.S. manufacturing. Before turning to ways to address these problems, I would like to focus on another challenge to the competitiveness and job creation potential of this sector. This concerns the ability to sustain the current advantage of U.S. science, engineering, and technology in global markets which in turn allows us to compete successfully in advanced manufacturing sectors which are the key to the future of the manufacturing sector. Government policy can play an important role in meeting this challenge as well.

Table 1

Effect of Key "Overhead Costs" on Raw Cost Index of Nine Largest U.S. Trading Partners, 2002

(U.S. dollars per hour)

	United States	Average of nine partners	Canada	Mexico	Japan	China	Germany	United Kingdom	South Korea	Taiwan	France
Raw cost index	**24.30**	**19.30**	**27.57**	**8.11**	**16.92**	**5.34**	**29.60**	**28.30**	**23.96**	**16.41**	**26.50**
	Difference relative to U.S. costs in percent										
Corporate tax rate	–	-5.6%	-3.4%	-6.0%	2.0%	15.0%	-0.4%	-10.0%	10.3%	-15.0%	-5.7%
Employee benefits	–	-5.5%	-4.8%	-9.4%	-9.4%	12.6%	3.6%	-5.1%	9.0%	-11.5%	10.7%
Tort costs	–	-3.2%	-3.1%	N/A	-3.3%	N/A	-0.7%	-3.4%	N/A	N/A	-1.3%
Natural gas costs	–	-0.5%	-6.0%	-2.3%	12.5%	-2.3%	0.6%	2.1%	4.1%	15.3%	-4.2%
Pollution abatement	–	-3.5%	-2.8%	N/A	-2.3%	N/A	-2.4%	-3.0%	N/A	N/A	-1.5%
	Manufacturing production costs relative to the United States accounting for differences in overhead costs (dollars per hour)										
Effective cost index	**24.30**	**16.02**	**22.46**	**6.19**	**16.64**	**3.50**	**29.77**	**23.14**	**22.67**	**12.85**	**25.77**

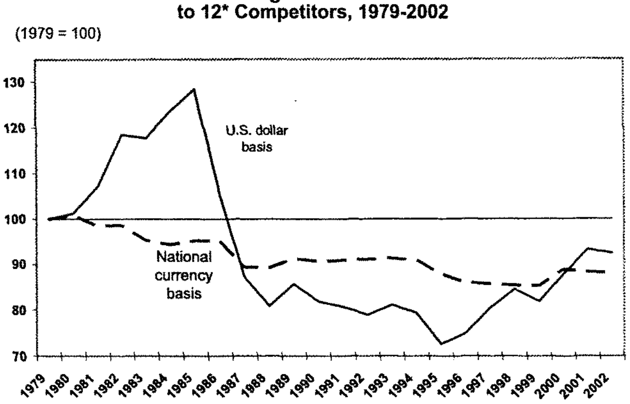
Source: Author's calculations based on data in subsequent tables and charts

Note: Data for tort costs and regulatory compliance costs are limited to the industrialized partners. Conservative assumptions have been made in estimating the missing values, as described in later sections. Thus, the absence of these data likely understates the overall cost advantage of U.S. trading partners.

[13] Jeremy Leonard, *How Structural Costs Imposed on U.S. Manufacturers Harm Workers and Threaten Competitiveness* (Washington, DC: National Association of Manufacturers and Manufacturers Alliance/MAPI, 2003).

[14] See Ernest H. Preeg, "Exchange Rate Manipulation to Gain an Unfair Competitive Advantage: The Case Against Japan and China," in C. Fred Bergsten and John Williamson, eds., *Dollar Overvaluation and the World Economy* (Washington, DC: The Institute for International Economics, 2003).

Chart 7
U.S. Manufacturing Unit Labor Costs Relative to 12* Competitors, 1979-2002



*Korean data begin with 1985 and have been omitted from this chart.
Source: U.S. Department of Labor, Bureau of Labor Statistics

According to the independent World Economic Forum, the United States is still the world leader in technology, based both on its commitment to research and its ability to bring innovative products to market. Table 2 gives the most recent rankings of this Swiss-based organization and shows that this lead is the key factor in keeping the United States near the top in global competitiveness rankings. Importantly, this group ranks the United States first in its Technology Index, due especially to its strong innovation performance. The NSF concurs that ". . . the United States continues to lead, or be among the leaders, in all major technology areas . . .," and rates ". . . the United States as the world's leading producer of high-technology products . . . ."[15] One measure cited by the NSF as a sign of the resurgence of U.S. technology was the increase in the share of U.S. patents granted to U.S. nationals. Since peaking in 1989, the share of patents granted to foreign nationals in the United States has fallen from 48 percent to 44 percent. Additionally, "U.S. inventors led all other foreign inventors [in patenting their products] not only in countries bordering the United States but also in markets such as Germany, Japan, France, Italy, Brazil, Russia, Malaysia, and Thailand."[16] The United States is especially active and leads the world in some bright new areas for growth such as DNA-related patents and patents related to development of the Internet. Nonetheless, despite this position of leadership, there are some signs that the dominant position held by the United States is beginning to slip.

[15] National Science Foundation, *op. cit.*, p. 38.

[16] *Ibid.*, pp. 6-21 to 6-24.

Table 2
Business Competitiveness Rankings, 2003

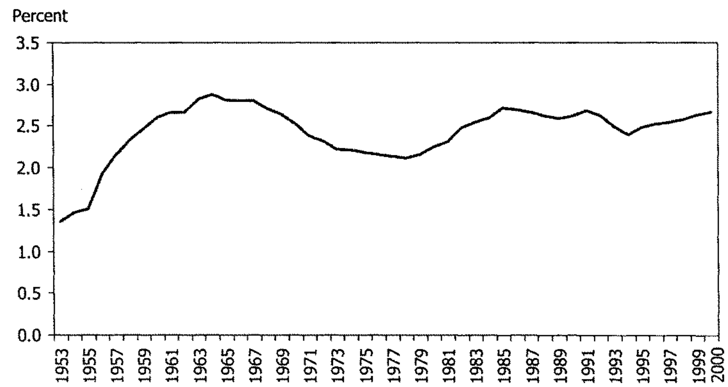
Country	Business Competitiveness Ranking 2003	Technology Index Rank	Business Competitiveness Ranking 2002*
Finland	1	2	2
United States	2	1	1
Sweden	3	4	6
Denmark	4	8	8
Germany	5	3	4
United Kingdom	6		3
Switzerland	7		5
Singapore	8		9
Netherlands	9		7
France	10		15
Australia	11		14
Canada	12		10
Japan	13		11
Iceland	14		17
Belgium	15		13
Taiwan	16		16
Austria	17		12
New Zealand	18		22
Hong Kong SAR	19		19
Israel	20		18

*Applying 2003 formula
Source: World Economic Forum

We have already mentioned the recent trade deficit in advanced technology products. While this is due in large part to the strong dollar, severe cost pressures on domestic producers and increased competition, some data indicates that our science and technology lead is not as secure as it was a few years ago, and that our commitment to funding the required research and education is not quite as solid as needed to maintain our competitive edge.

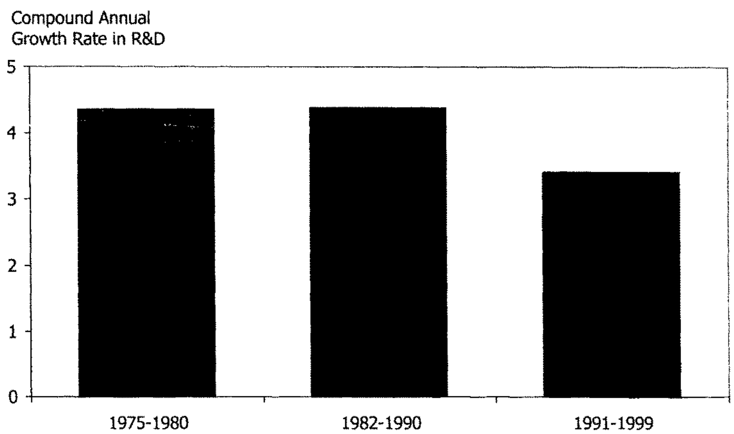
In the first place, national funding for R&D and basic science from all sources, especially that related to manufacturing such as the physical sciences and engineering, has been flat to slightly declining as a proportion of national output. Chart 8 reviews the historical pattern of R&D expenditures as a proportion of GDP. While the United States still leads all industrial nations except Japan in this measure of support for R&D, there seems to be a waning in the willingness or ability to maintain vigorous growth. Chart 9, for instance, chronicles a modest slowdown in the growth rate of R&D during the long boom of the 1990s, which was of course dominated by the technology-intensive fields such as communications and information technology, when compared to the two previous periods of expansion. Most of this decline is attributable to lower federal support in the 1990s.

Chart 8
Historical Pattern of R&D as a Percentage of GDP, 1953-2000



Source: National Science Foundation, *Science and Engineering Indicators—2002*

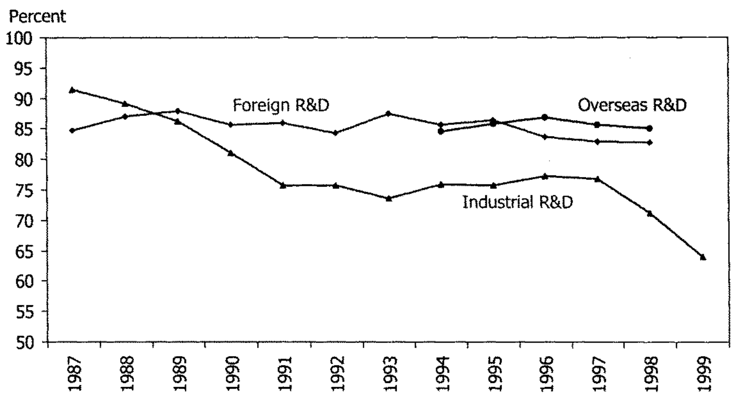
Chart 9
Compound Annual Growth Rate in R&D During Economic Expansion Periods, 1992 Dollars



Source: National Science Foundation, *Science and Engineering Indicators—2002*

The manufacturing share of R&D, while still above 60 percent of the total, has also declined in the past few decades as a proportion of total industrial R&D, as Chart 10 shows. This may be due in part to the rise of spending on related areas such as research on software and IT systems related to manufacturing, and the growth of research spending by the services sector. The steady decline in cash flow of the manufacturing sector may also explain some of the lack of dynamism in manufacturing R&D. Since 1990, the cash flow of U.S. manufacturers has fallen from 37.2 percent of total corporate cash flow to 25.3 percent in 2001, reflecting the cost pressures and global competition affecting this sector.[17]

Chart 10
Manufacturing Shares in Foreign, Overseas, and Total Domestic Industrial R&D, 1987-1999



Source: National Science Foundation, *Science and Engineering Indicators—2002*

Federal government expenditures for basic science and R&D, especially those areas directly related to manufacturing, have also failed to keep pace with the overall growth of the economy. Some growth in the past two years in R&D outlays only allowed the real level of support to return to 1987 levels. The most spectacular example of this long and steady erosion of support is for space research. While no one would want to recreate the circumstances of the 1960s, namely the threat from the Soviet Union, that motivated much of the spending for the Apollo program, the benefits to high tech manufacturing from the space and national defense programs of the times were large and extended into the 1990s at the very least. In 1965, federal R&D (including plant and equipment) for the National Aeronautics and Space Administration (NASA) was three-quarters of one percent of total GDP. Combined with Department of Defense (DOD) expenditures, R&D in 1965 supported by these two agencies was equal to fully 1.7 percent of GDP. By 2002, NASA research was down to .09 percent of GDP and the combined NASA/national defense expenditures totaled only .42 percent of GDP, less than one-quarter the rate of 1965.[18] Federal spending in basic sciences related to manufacturing have also trended downward over the past three decades. In 1976, fully 43 percent of all federal expenditures for research, largely conducted by universities and federal labs, was devoted to engineering and the physical sciences. In 2002, that proportion had fallen to 26.8 percent. At the same time, research in the life sciences grew from 43 percent to 48 percent of the total. Overall, federal support for basic research has increased as a proportion of all federal science spending in recent years. In 2002, about .43 percent of GDP was devoted to all scientific research supported by the federal government.

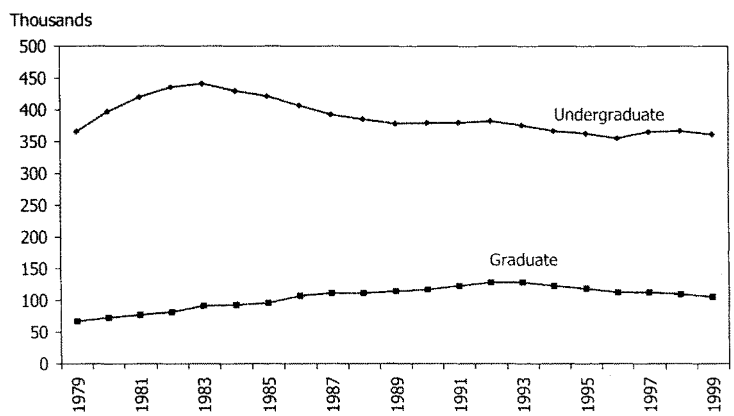
[17] Data are from the U.S. Department of Commerce, Bureau of Economic Analysis.

[18] National Science Foundation, *op. cit.*

The training of scientists and engineers too has fallen from its levels three decades ago. In the 1960s and 1970s, there was a palpable sense of excitement, adventure, and a clear national purpose associated with scientific and engineering projects such as the Apollo program, development of large commercial aircraft, the early development of robotics and automation equipment, and the nascent industry of computing. This inspired students to enroll in related educational fields, and students were assisted by generous federal programs such as the fellowships awarded by the NSF and under the National Defense Education Act. Chart 11 depicts the slow decline in engineering enrollment in the United States since peaking in the early 1980s. Chart 12 shows slippage in graduate enrollment in advanced U.S. science and engineering programs over the past two decades. Undergraduate degrees awarded in engineering have fallen by almost 20 percent since 1987, those in the physical sciences by about 5 percent, and those in the critical-related area of mathematics by over 20 percent in the same timeframe. On a brighter note, degrees in the biological sciences, a potential source of technological strength and new products in the 21st century, have grown by nearly 70 percent since 1986, as Chart 13 shows.

The overall decline in the education of mathematicians, physical scientists, and engineers is cause for concern because demand for these skills is outpacing the economy-wide growth in demand for all workers, according to the U.S. Department of Labor. The latest projections (again, these are somewhat dated) are for overall employment to grow by 0.3 percent per year in the first decade of the new millennium, while that for computer- and math-related occupations grows 2.6 percent, architecture and engineering jobs by 0.4 percent, and those in the life, physical, and social sciences by 0.9 percent.[19]

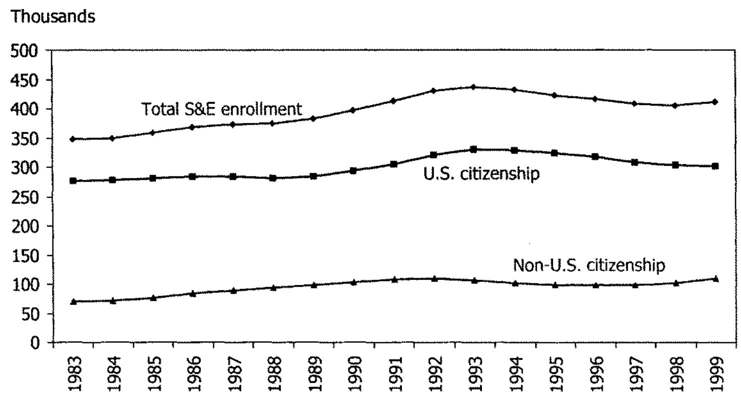
Chart 11
U.S. Engineering Enrollment, by Level, 1979-1999
(Full- and part-time students)



Source: National Science Foundation, *Science and Engineering Indicators—2002*

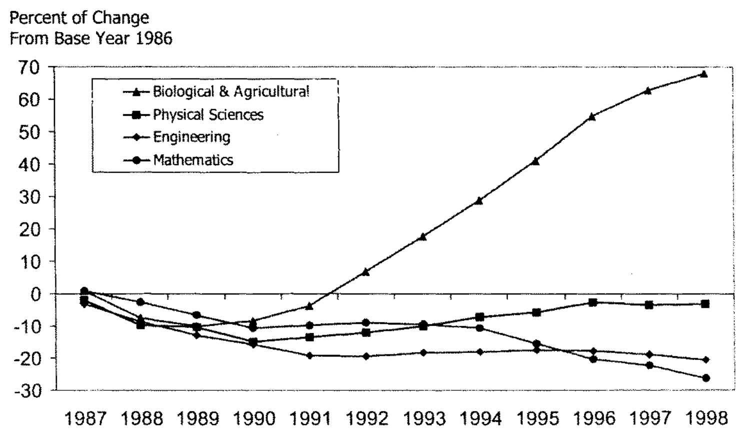
[19] U.S. Department of Labor, Bureau of Labor Statistics, November 2001.

Chart 12
Graduate Enrollment in Science and Engineering by Citizenship, 1983-1999



Source: National Science Foundation, *Science and Engineering Indicators—2002*

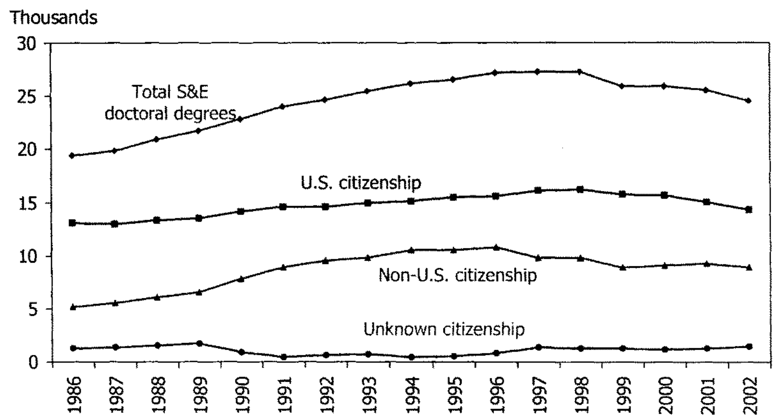
Chart 13
Growth in Undergraduate Science and Engineering Degrees, Indexed to 1986



Source: National Science Foundation, WebCASPAR database, www.nsf.gov

The United States higher education system has a lead on its competitors by almost any measure of quality. One result is that foreign students flock to the shores of the land of opportunity, especially to receive training in the sciences and engineering. Foreign students are especially prominent in the advanced study of these fields. Chart 14 shows that almost all the growth in the awarding of Ph.D.s in science and engineering results from an increase in those earned by non-U.S. citizens.

Chart 14
Earned Science and Engineering Doctoral Degrees by Citizenship, 1986-2002



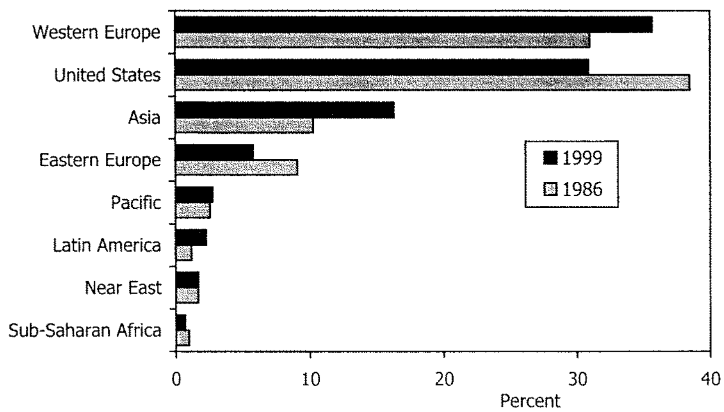
Source: National Science Foundation, WebCASPAR database, www.nsf.gov

While many of the U.S.-trained foreign students remain in this country and add immeasurably to the research and entrepreneurial dynamism of the domestic economy, many return home and transfer their knowledge to local industries. China, for instance, has sent over 600,000 of its youth to study in the United States in the past 25 years, and only 160,000 have returned to the motherland. In recent years, the pace of return to China has picked up speed as opportunities in China are flowering and the Chinese government gives new incentives to those who come back. Over 90 percent of the 18,000 students who returned to China in 2002 hold a masters or doctoral degree from abroad.[20] Taiwan, South Korea, India, Mexico, Thailand, Malaysia, and Japan also send large numbers of students to the United States and are reaping the benefits through growth of the high-technology industries whose most important ingredient is the brainpower of trained researchers.

One measurable result of the slight fall in interest and enrollment in science and engineering on the part of U.S. students, and of the flattening of financial resources devoted to these fields, is that the traditional lead of American researchers in science publications is being slowly whittled down. While the prestige awards like Nobel prizes continue to be dominated by U.S. scientists, the mass of research which underpins broad scientific excellence and technological leadership is being globalized. Chart 15 chronicles the decline in "market share" by the United States of gross output of scientific research in the 1990s. Asian and West European researchers increased their market share during this period of strong economic growth. Chart 16 gives a measure of quality and importance of research, the number of times research is cited in other scientific papers. Even though the United States is still well in the lead in this measure, the lead is eroding.

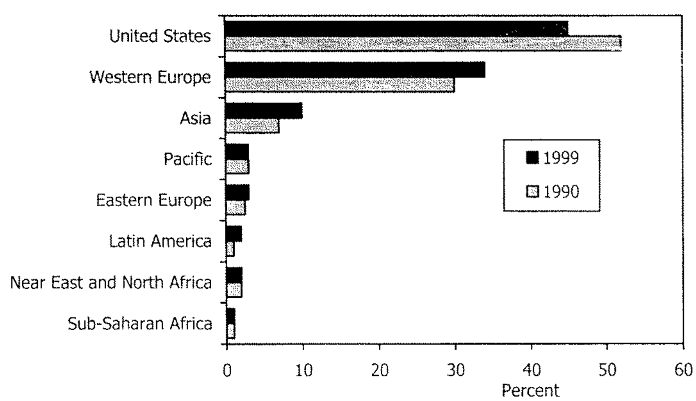
[20] See "On Their Way Back," *The Economist*, November 6, 2003, pp. 59-60.

Chart 15
Scientific Publications: Regional Share of World Output



Source: National Science Foundation, *Science and Engineering Indicators—2002*

Chart 16
Scientific Research Cited by Scientific and Technical Papers, by Region



Source: National Science Foundation, *Science and Engineering Indicators—2002*

Although the United States has increased its market share of patent activity since 1989, it is worth noting that foreign corporations are increasing their patenting activities, especially companies from South Korea and Taiwan. Chinese firms are sure to start showing more activity in coming years. For the period 1977-1996, six of the top ten corporations for U.S. patent awards were American firms, while in 1999 that number had fallen to three. In 1999, six Japanese and one Korean (Samsung) firm were among the top ten for patent awards.[21]

It is important to retain perspective on this brief review of scientific research and education over the past few years. It does show flat to slightly lower commitments to these areas in the United States and comparatively stronger growth among major economic competitors in Asia and (in part) in Western Europe. The United States still maintains the preeminent position, but its leadership is being challenged. Combined with the cost advantages enjoyed by competitors in Asia, the growing sophistication of Asian scientists and engineers, often learned in the United States, helps to explain the small erosion of competitiveness in world markets for products with a high degree of embedded technology.

III. Ways to Address the Challenges Facing Manufacturers

It is important for federal policymakers to address the issues currently facing U.S. manufacturing because this sector is a driver of growth, innovation, and productivity throughout the economy. As such, it is a primary source of improvement in domestic standards of living and international competitiveness. A strong manufacturing base, especially in advanced technologies, of course is also of immense importance to maintaining our national security.

There are a variety of ways in which federal policy can play a constructive role in establishing the conditions needed for the continued vitality and global competitiveness of this sector in the United States. I first focus on some general policies which would help meet the cost pressures facing domestic manufacturers. Then I turn to policies which support the core strength of U.S. manufacturing, namely the highly innovative, research-oriented, technology-intensive, fast-changing, and flexible manufacturing model which is most likely to enjoy success in global markets.[22]

Currently, a variety of cost differentials with major trade competitors cumulatively add at least 22.4 percent to domestic costs of manufacturing. The major challenges which can be addressed by federal (and, in some cases, state) policy include:

- ***Tax policy.***—U.S. corporate income tax rates are the second highest in the industrialized world, after Japan, and competitors such as Germany and Russia are lowering corporate tax burdens. Corporate income taxes should be lowered or eliminated. Additionally, depreciation rates are often out of step with the real economic life of capital goods used in manufacturing or in the provision of IT services; and U.S. tax structures also discourage investment through the double taxation of dividends and other measures. Capital-intensive manufacturers are especially disadvantaged by the high burden of taxation on capital. Finally, making the R&D tax credit permanent would add certainty to the research and innovation so crucial to U.S. manufacturing.

- ***Health care policy.***—Provision of health care is the fastest rising cost facing manufacturers. Reforms are needed to provide incentives for more efficient use of services and to give health care consumers a better awareness of the trade-offs between cost and quality of overall care.

- ***Legal reform.***—The costs of various kinds of liability and torts faced by U.S. manufacturers are at least double those of major international competitors. Serious reform of the tort,

[21] National Science Foundation, *op. cit.*, p. 6-22.

[22] For more detailed discussion of policy responses, see Duesterberg and Preeg, *U.S. Manufacturing: The Engine for Growth in a Global Economy*, *op. cit.*, Chapter 9; and Leonard, *How Structural Costs Imposed on Manufacturing Harm Workers and Threaten Competitiveness*, *op. cit.*, pp. 24-25.

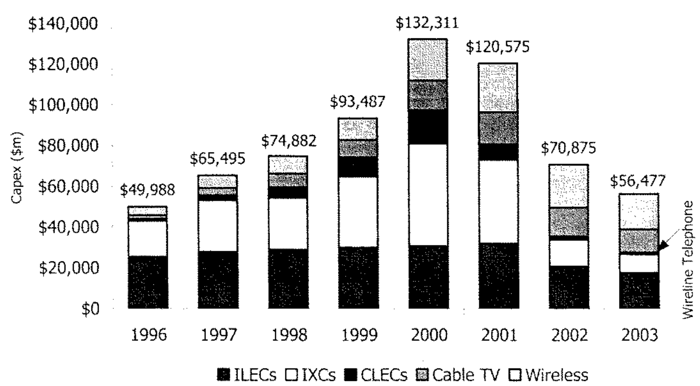
product liability, and class action regimes is needed. Addressing the asbestos crisis should have top priority.

- ***Regulatory reform.***—Environmental, health and safety, and other regulatory mandates tend to add costs to American manufacturers. Attention to the trade-offs between the necessary goals of such regulation and the costs needs to be heightened and cost-benefit analysis needs to be employed more widely.

- ***Energy costs.***—The secular rise in energy costs, especially for natural gas, has undermined the competitiveness of energy-intensive industries like primary metals, paper and glass, and chemicals, while adding to the costs of almost every manufacturing sector. Broader development of domestic and North American resources to reduce cost pressures is urgently needed.

I would like to dwell briefly on one area of regulatory policy which greatly affects an important, high-technology sector. Telecommunications policy is often viewed as a zero-sum game of competing claims between various classes of service providers, or as a purely intramural fight which has few real-world consequences. Unfortunately, we can no longer be so complacent. The rise of telecommunications capital investment was of course crucial to the spread of the Internet in the 1990s, and continued investment is required to perfect the IT infrastructure so crucial to enhanced productivity in the modern economy. Growth in capital investment by the telecommunications and IT industries between 1996 and 2000 added nearly one full percentage point to U.S. GDP growth and contributed greatly to enhanced productivity by lowering consumer prices and expanding the communications net by many orders of magnitude.[23] Since 2000, however, the investment bubble has burst, as capital expenditures for communications equipment plummeted by 57.3 percent, as Chart 17 illustrates.

Chart 17
U.S. Telecom Service Providers Capital Expenditures, 1996-2003



Source: T. Rowe Price & Company Reports

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[23] See Thomas J. Duesterberg and Jeremy Leonard, *The Telecommunications Sector and Economic Recovery* (Arlington, VA: Manufacturers Alliance/MAPI, 2001), Economic Report 526, September 2001.

This precipitous fall is important to U.S. manufacturers because a good deal of the capital equipment is produced domestically, and without continued strength we will experience a loss of critical mass needed to support R&D and continued technological leadership. Over 86.6 thousand jobs, or 34 percent of the workforce in this industry, were lost in the manufacture of communications equipment after 2001, on top of over 200,000 jobs lost in the telecom services area.[24] Importantly, due to lack of investment, the United States is falling behind leading competitors in the provision of the high-speed data connections which are so crucial to the continued competitiveness of the U.S. economy. Table 3 shows the rate of broadband access among leading OECD countries as of June of this year. The United States trails such competitors as Korea, Japan, and several European nations.

Table 3
Broadband Access in OECD Countries per 100 Inhabitants, June 2003

	DSL	Cable Modem	Other Platforms	Total
Australia	1.48	1.11	0.07	2.65
Austria	2.76	4.22	0	6.98
Belgium	6.25	3.82	0.27	10.34
Canada	6.09	7.18	0	13.27
Denmark	7.29	3.17	0.65	11.11
Finland	5.39	1.21	0.01	6.61
France	3.56	0.57	0	4.13
Germany	4.68	0.06	0.10	4.84
Iceland	10.66	0	0.56	11.22
Italy	2.50	0	0.34	2.84
Japan	6.49	1.75	0.36	8.60
Korea	14.36	8.45	0.37	23.17
Luxembourg	2.02	0.24	0.06	2.32
Mexico	0.12	0.15	0.001	0.28
Netherlands	3.82	5.38	0.001	9.20
New Zealand	1.87	0.06	0.14	2.07
Norway	4.08	1.17	0.14	5.39
Spain	3.24	1.00	0	4.24
Sweden	5.44	1.96	1.76	9.16
Switzerland	4.70	4.43	0	9.13
United Kingdom	1.78	1.82	0.02	3.63
United States	2.68	4.84	0.74	8.25
OECD (Average)	3.37	2.40	0.29	6.06
EU (Average)	3.31	1.10	0.14	4.55

Source: Organization for Economic Cooperation and Development, www.oecd.org/sti/telecom

According to a recent study by three Nobel prize-winning economists and a leading expert on prices, the current maze of regulation employed at the federal and state levels seriously discourages investment and innovation in telecommunications. The four economists conclude:[25]

> It is our view that current telecommunications regulations threaten to reduce the pace of technological gains by reducing the incentives of local exchange carriers ("ILECs") and competitive local exchange carriers ("CLECs") to invest in new services and to upgrade their networks. . . . When, as today, new telecommunications

[24] U.S. Department of Labor, Bureau of Labor Statistics, and Dun and Bradstreet.

[25] "Report of Kenneth Arrow, Gary Becker, Dennis Carlton, and Robert Solow On Behalf of Verizon" (Chicago, IL: Lexecon, November 18, 2003), p. 3.

technologies are emerging rapidly, firms must decide whether to make large and risky investments in these new technologies. These are precisely the circumstances in which there is an increased likelihood that inappropriate regulation will adversely affect productivity growth and consumer welfare.

To underscore their arguments regarding the impact of lower investment due to inappropriate regulation, these award-winning economists state: "The resulting harm to the U.S. economy could be large and could extend beyond the telecommunications sector."[26] Some of the changes needed to address this problem include providing full tradable private property rights to wireless spectrum holders, ending the counterproductive requirements to share facilities at less-than-economic rents for service providers, and avoiding new regulation of cable, Internet, and wireless telephony and data services.[27]

We also need to be very vigilant about how we regulate (and pay for) another high-technology sector: medical products. As we noted earlier (see Chart 13), biotechnology and life sciences is the one area where U.S. R&D and production of advanced degrees has increased, and one where the United States enjoys a competitive advantage in the production of related products. The research lead in this sector is currently enhanced by a more favorable regulatory environment in the United States. Japan, Europe, Canada, Australia, and other leading industrial countries discourage investment in biotechnology and health care products through heavy-handed regulation of bio-engineered foods and through their command-and-control health care payment systems. If we are to maintain our lead, we will need to avoid replicating such harmful policies and work assiduously to fend off the efforts of Europe and others to use the World Trade Organization (WTO) to thwart research and the use of biotechnology products.

In a more general sense, protection of intellectual property such as pharmaceuticals, medical devices, microprocessors, and telecom equipment through the WTO and through our growing array of bilateral and regional trade agreements should be a general and ongoing priority of the U.S. trade authorities. This is especially true since the future of U.S. manufacturing is increasingly tied to its ability to provide innovative products embodying new and proprietary technology. The many examples of theft of protected products such as pharmaceuticals, movies, and even designs for new cars are well known. New assaults are waged with growing frequency as countries such as Brazil, India, South Africa, and China attempt to undermine existing protections or ignore them in order to support new domestic industries. China, to take a recent example, is trying to develop domestic DVD and wireless phone technologies to compete with—or undermine—dominant U.S. and European standards.[28] Computer software is another ongoing target of IP pirates, especially in Asia. Entrepreneurial thieves in Malaysia are already selling the next version of Windows, slated for release by Microsoft in 2005! "Malaysia's brazen software pirates are hawking the next version of Microsoft Corp.'s Windows operating system years before it is scheduled to be on sale," read a recent dispatch from Reuters.[29]

Trade policy, in a broader application, is important to lowering existing barriers to the sale of manufactured goods in foreign markets. While average tariff levels for goods imported into the United States are only 4.3 percent, Brazil imposes average tariffs of 13.9 percent, India 32.4 percent, China 16.9 percent, Egypt 20.2 percent, Russia 13.4 percent, Nigeria 24 percent, South Korea 7.8 percent, Poland 10.9 percent, Thailand 14.6 percent, Saudi Arabia 12.6 percent, and Pakistan 46.9 percent. The Alliance has long supported free and open trade and aggressive policies to achieve this goal by opening foreign markets and lowering these too-high tariffs. It is equally important to pay attention to faithful enforcement of agreements. Secretary of Commerce Donald Evans has

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[26] *Ibid.*, p. 23.

[27] See Duesterberg and Preeg, *U.S. Manufacturing: The Engine for Growth in a Global Economy*, *op. cit.*, pp. 210-213.

[28] See "China Armed with EVD in 'Attack' on Dominant DVD," *The Washington Times*, November 17, 2003, p. A1.

[29] "Asian Pirates Sell Microsoft's Next Windows System," Reuters, December 1, 2003, 7:49 AM EST.

announced plans, for instance, for special monitoring of China's compliance with its new WTO obligations, a much-needed initiative.

In the wake of the hopefully temporary collapse of the WTO round, constructive progress can and should be made through regional and bilateral deals such as the Administration currently is pursuing in the Americas, and with countries like Thailand and Australia. The Alliance also supports an initiative announced by U.S. Trade Representative Robert Zoellick to achieve free trade in the manufacturing sector.[30] Given the long-standing difficulties of our negotiators to make progress with Japan, Korea, and Europe on agricultural trade, given the overwhelming predominance of goods in U.S. trade, and given support for this initiative by key allies in Britain, now is an auspicious time to move this idea to the forefront of the multilateral agenda.

Exchange rate policy has also come to the fore in influencing U.S. international competitiveness in manufactures and as a major cause of the sharp increase in the U.S. trade deficit in recent years. The Alliance supports the Administration policy of market-based exchange rates. Unfortunately, a number of East Asian trading partners, most importantly China and Japan, have been intervening heavily in financial markets to buy dollars in order to maintain their currencies substantially below market-based levels. This, of course, provides them with an unfair competitive advantage in trade. Such "currency manipulation" is in violation of IMF and WTO commitments,[31] and the Administration should take appropriate action to stop it.

Finally, I believe policymakers should reflect on the relationship between our national investment in science and technology and in education, and the future health of the manufacturing sector. A few years ago I frequently heard from manufacturing executives of a shortage of both skilled workers and of a lack of interest on the part of academic and advanced researchers in areas of interest to manufacturing. In fact, despite major private sector investment in technical education and scientific research, students frequently are not attracted to the disciplines like engineering which are so crucial to the success of manufacturing, especially in an age of innovation and rapid changes in technology. This is in sharp contrast to the 1950s and 1960s, and perhaps even to the 1990s, when the race for space, the competition to build the biggest and best commercial aircraft, computer, or robot, and, later, the lure of IT entrepreneurialism in Silicon Valley attracted the best and the brightest.

In the 1950s and 1960s, if not beyond those years, NASA and other agency programs played a major role in supporting needed research. The centrality and visibility of federal support also added to the allure of making a contribution to large national goals such as being the first to land on the moon or building the fastest supercomputer. Today, federal financial support for similar activities is only a fraction of what it was 40 years ago. Perhaps more importantly, national leaders are not articulating national goals which inspire our young people to enter the science and engineering fields which once were imbued with glamour and excitement.

In today's fiscal environment, it is unrealistic to expect major infusions of funds to basic research and to R&D that would return us to the levels of the 1960s. Moreover, it is questionable if major funding increases would work as effectively as before in a world of rapid technical change where industry is much more adept at deploying resources to the best possible uses. One could legitimately ask, however, whether existing federal support is as effective as it should be in supporting the types of science and engineering education and research that provide a foundation for advanced manufacturing, technological innovation, and national defense. Clearly we are not producing the personnel and the R&D needed to maintain the same technological lead we enjoyed in the 1980s and 1990s.

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[30] Ernest H. Preeg, *Free Here to Free Trade in U.S. Manufactures: How and Why* (Arlington, VA: Manufacturers Alliance/MAPI, 2003).

[31] See Ernest H. Preeg, "Chinese Currency Manipulation and the U.S. Trade Deficit," testimony before the U.S.-China Economic and Security Review Commission, September 25, 2003.

One could also legitimately ask whether the sort of inspired leadership we saw in the 1960s to challenge our students and researchers could not be replicated to at least some extent today. National leaders rarely speak of or make appearances with technology leaders. Many technologies pioneered in the United States—microprocessors, advanced materials, biotechnology, and nanotechnology—are vitally important to our manufacturing future and could be aided by the attention and endorsement of national leaders, and by judicious support using existing funds. Can we not also imagine more inspirational programs—deep space exploration, a return to the moon, new materials and propulsion technologies to allow manned flight to Mars and beyond, enhanced sensor technologies to root out national security threats, pushing the limits of nanotechnology, ending hunger and environmental degradation through new biotechnology, finally conquering cancer through genetic technology—where national leadership and investment would be constructive in attracting the best and brightest? If we could do this in a sustained way, it would work wonders too for the future competitiveness of the manufacturing sector which would lead in performing research and developing the new products required to meet national goals and sustain our global competitiveness, just as it did 40 years ago.

Let me be clear that I am not advocating a huge increase in federal resources to regain the glory days of the 1960s. Rather, I believe we should be using our resources much more wisely in ways that advance the national interest and aid in sustaining U.S. competitiveness, especially in the advanced technology areas which tend to produce good jobs. The lion's share of research is going to continue, and should continue, to be provided by the private sector, which is much more adept at getting resources to the best possible uses. But policymakers can help in the following ways:

- improving elementary and secondary education in math and science training;
- supporting advanced training in engineering and the physical sciences;
- establishing clear and inspirational national goals for our space and national health research programs which both meet national needs and attract students to the academic disciplines needed to carry out these programs;
- supporting the basic research needed to buttress development of new areas such as biotechnology, nanotechnology, and advanced information technology that cannot be carried out efficiently in the private sector;
- supporting the necessary programs to ensure development of the technologies needed to meet national security threats;
- streamlining and accelerating the drug and medical device approval process at the Food and Drug Administration;
- making the R&D tax credit a permanent part of the IRS code to promote research and innovation; and
- modernizing the U.S. Patent and Trademark Office so that it can more rapidly and efficiently assess the flood of new applications for intellectual property protection.

More judicious and thoughtful policy and financial support in these areas will pay larger dividends in the future, not the least of which is assisting the vitally important manufacturing sector in its core mission of technological innovation.

Tim Hawk
Superior Metal Products/AmericanTrim LLC

The Subcommittee on Oversight of Government Management,
the Federal Workforce and the District of Columbia

- 12/09/03 Hearing -
"Fair or Foul: The Challenge of Negotiating, Monitoring, and enforcing U.S. Trade Laws."

Slide #1
I would like to thank the Subcommittee for allowing AmericanTrim the opportunity to present today. AmericanTrim is a 50 year old manufacturing business that supplies component parts and assemblies to the automotive and appliance industry. We stamp, decorate and finish products that are seen and used in many households and vehicle system. We employ over 1500 families and operate facilities in 4 states. I am a third generation owner/operator.

Our company's "Tag line" is *"Forming the Future."* I hope that today our small company might have an influence on the formation and enforcement of future trade laws, policies and practices.

Slide #2
Today I will provide you an overview to why the US manufacturing sector is losing jobs at an alarming rate. As you know, 2 million jobs have been lost and we have had 34 straight months of manufacturing job losses.
You have given me 5 minutes today and I will give you our company's "2 cent" perspective for why the loss and why the continued loss if action is not taken. Simply

put, its all about the other non-controllable costs that we are saddled with that makes us uncompetitive. This includes rising Healthcare, Environmental, OSHA and basic utility costs.

The Part I am holding here has been made for more than 30 years. We have made over a billion of these parts. We have invested millions of dollars in high tech automation to eliminate the labor cost to manufacturer. My predecessors had the foresight to being and achieving the world's low cost producer of this product. This product has 2 cents of labor cost. Those costs include all the labor to convert the metal from a flat piece of metal to a finished product and shipment to the customer.

The competitiveness and viability of this product and the lives of the people it employs is being challenged by low cost labor countries and their ability to buy and process commodities (steel) cheaper than us. We recognize that China, India and Indonesia offer labor rates at 90% cheaper to the US. We don't consider that a factor in competing with them due to the automation and productivity levels we currently achieve.

Slide #3

I recently conducted a competitive bid process for this product in China. My goal was to understand their direct material and labor content associated with this product. Much to my surprise, material was 25% cheaper than what we can procure it for. The ability to start off with a 25% advantage to us is a bit alarming. I researched other materials (e.g. plastic resins, etc.) and have found similar stories in different industries. The purchasing power parity (PPP) seems to be out of balance. I am by no means an expert on currency manipulation and its inter-relationship on PPP. All I can surmise is that the playing field is tilted away from fair trade.

Now let's talk about the other costs besides material and labor. These costs are almost non existent to low cost labor countries. These include costs for healthcare, environmental and safety compliance and utility costs.

As a percent of revenue, our company operates at a 22% cost disadvantage due to the un-level playing field. As you can see, it not necessarily about the labor costs but all the other cost drivers we struggle with on a yearly basis.

Slide #4

There appears no end in sight for the ongoing cost escalation in healthcare and utility costs. Natural gas, which is used to heat our facilities and run our manufacturing processes have increased 122% since 1998. Healthcare costs have risen 63% since 1999 and is approximately 5% of total company revenue.

Slide #5

The original equipment manufactures (OEMs) have been developing strategies for sourcing products in China for some time. This includes the likes of General Motors, Ford, General Electric, Whirlpool and Electrolux. They all have very lofty goals for China sourcing. Ford has a target of $10 billion within the next 5 years. How many US businesses do you think will be lost?

They have one simple message for us. Match the China price or else. The "or Else" is being eliminated as a supplier and the continued creation of more job loss. General Electric is in the midst of following through on the "or else", costing people their jobs and reducing the amount of taxes paid.

Slide #6

The OEs are strategically organizing their China efforts. They are developing in-country beach heads and establishing very elaborate "commodity filters" for evaluating products. Products are screened or plotted by two dimensions – degree of value add (e.g. labor) and relative packaging density. Packaging density relates to the ability to ship many parts in a container. If they "nest" and have high labor content they are likely candidates for importing.

Conclusion

I think we all can see why China is an attractive place to manufacture goods and why companies will continue to pursue sourcing goods in that region of the world. It's all about year over year cost reductions that are need by the large multi-national companies.

I was asked by a government official if we had any plans to manufacture products in China. I responded, I thought it was about keeping and securing jobs in the United States, including the flow of taxes (payroll and company) to the government.

I stand here today wondering if anything will be done or will we just watch another industry sector pass. I am "a hopeful manufacturing romantic" but I can't realistically tell our employees that the future is prosperous and bright.

Charles W. Freedman, III, Deputy Assistant, U.S. Trade Respresentative, Questions for the Record from Senator Lieberman

1. There is currently a serious concern regarding the loss to the U.S. economy of the high-end semiconductor chip-manufacturing sector and the likely subsequent loss of the semiconductor research and design sectors. East Asian countries are leveraging market forces through their national trade and industrial policies to drive a migration of semiconductor manufacturing to that region, particularly China. The Chinese central government has undertaken indirect subsidies in the form of a substantial rebate on the value-added tax (VAT) charged on Chinese-made chips. Currently the Chinese government is providing a 14% rebate on VAT to customers who buy Chinese-made semiconductor chips, essentially providing a large subsidy of their domestic industry in clear violation of GATT rules. Thus, U.S.-made chips would pay a 17% VAT, and Chinese-made chips would pay a 3% VAT. Given the tight price competition of chips and the growing importance of the Chinese chip market, this is a very significant step toward ending U.S. production. It is important to ensure that GATT rules are properly enforced in this instance, and not allow government imposed advantages for foreign competitors to damage U.S. manufacturers.

USTR has been reviewing whether to bring an unfair trade practices case on these issues given the apparent violation of trade laws and treaties.

- **What decision has USTR reached on this and what are the reasons for its conclusion?**
- **Are there currently plans to undertake prompt bilateral negotiations to remove these measures?**

Under State Council Document 18 ("Several Policies for Encouraging....") and follow-on measures, China allows for a partial VAT rebate on sales of integrated circuits (ICs) produced in China, while imported ICs are subject to the full 17 percent VAT. China claims the rebate policy is a WTO-consistent research and development subsidy. However, as a result of the policy, imported ICs face a higher tax burden than ICs produced in China, which would seem to contravene WTO rules.

The Administration is seriously concerned about this differential treatment. USTR and the Department of Commerce have pursued this issue aggressively with China. We will be conducting further bilateral discussions on this issue in the lead-up to the meetings of the Joint Commission on Commerce and Trade, scheduled for April this year and to be chaired on the U.S. side by Ambassador Zoellick and Commerce Secretary Evans and on the Chinese side by Vice Premier Wu Yi. If we are unable to resolve the issue through these discussions, we will take prompt and appropriate action, including, if necessary, through the dispute settlement mechanism at the WTO.

2. Several Asian nations have for years intervened aggressively in currency markets to maintain their national currencies at artificially low values relative to the dollar. China, whose currency *(the renminbi, or yuan)* is thought to be undervalued by as much as 40 percent, and Japan, whose yen is undervalued by as much as 20 percent, are the two most obvious examples, but other nations including Taiwan and south Korea also have engaged in large-scale currency intervention. As a result of these currency manipulations, these nations have achieved and sustained an unfair advantage in international trade. A product from China, for example, starts out with up to a 40 percent price advantage over a comparable product from the U.S. solely due to this currency manipulation. The result is the gradual, inexorable destruction of manufacturing in the U.S. and month after month of job losses in manufacturing.

- **What is the exact status of Administration efforts to undertake bilateral negotiations with those nations that are most egregiously engaged in currency manipulation to bring an end to it?**
- **What trade case adjudications is the Administration considering to resolve these problems, and what decisions has it reached in this regard, including the reasons for same?**

USTR strongly supports the efforts of the President and Treasury Secretary Snow to encourage China and our other major trading partners to adopt market-based approaches to exchange rates. However, the Department of Treasury is in the most appropriate position to address currency matters. With respect to trade remedy approaches to this issue, including those under Section 301 of the Trade Act of 1974, we would evaluate any petition filed by the private sector based on its legal merits, although we believe this matter is best handled through the current efforts of Secretary Snow and others.