National Association of Manufacturers

MANUFACTURING MAKES AMERICA STRONG

Testimony

of Michael Campbell
Chairman, President and Chief Executive Officer
Arch Chemicals, Inc.

on behalf of **the National Association of Manufacturers**

before the **Senate Committee on Banking, Housing, and Urban Affairs**

on **"The Treasury Department's Report to Congress on International Economic and Exchange Rate Policy (IEERP) and the U.S.-China Strategic Economic Dialogue"**

January 31, 2007

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Mr. Chairman and Members of the Committee:

I appreciate the opportunity to participate in this very important hearing today. My name is Michael Campbell, and I am the CEO of Arch Chemicals, headquartered in Norwalk, CT. We are a global manufacturer of biocides, pool chemicals and other specialty chemicals. I am currently the Vice-Chairman of the National Association of Manufacturers and the Chairman of the NAM's U.S.-China Business Relations Task Force. I am also a member of ACTPN (Advisory Committee on Trade Policy and Negotiations) and the ACTPN China Task Force.

I am pleased to testify today on behalf of the National Association of Manufacturers (NAM) at this hearing regarding the Treasury Department's Report to Congress and the U.S.-China Strategic Economic Dialogue. The National Association of Manufacturers is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. We seek a vibrant, globally competitive manufacturing industry in the United States.

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

The NAM seeks a positive and mutually-productive trading relationship with China that reflects market forces as closely as possible. China's emergence as a leading world economy has meant significant new opportunities for many NAM members, including increased exports and investment.

However, these opportunities are not fully realized by all NAM members. Some of our members see prices of Chinese products so low – sometimes even lower than the cost of the raw materials -- that it is difficult for them to see how they can compete. Others see their customers moving to China and cannot find new ones to replace them.

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

The NAM's concerns with China cover a range of issues, including protecting intellectual property rights, maintaining a currency value that reflects the strength of the Chinese economy and ending prohibited government subsidization of industry. We are also concerned that we are seeing a growing Chinese industrial policy that favors domestic producers, making it more difficult for foreign firms to participate in the Chinese economy.

CHINA'S UNDERVALUED YUAN

On the issue of China's currency, manufacturers large and small are united. We may come from different points of view but we have all agreed that the Chinese government needs to allow greater flexibility in the value of the yuan. In September 2006, the NAM Board stated:

> "The Executive Committee reaffirms the NAM's policy as being that China's currency manipulation is a serious problem and that China

> should let the renminbi appreciate significantly. This represents a consensus of the full Board and a priority objective of the NAM."

There is no question that China's undervalued currency is having a very significant effect on U.S. manufacturers. NAM took the lead in pointing out the problem this was causing in U.S. trade and global imbalances as well as in Chinese efforts to develop a robust domestic economy. This is now almost universally-recognized, including by the IMF, the World Bank, many finance ministries and most economists. Chinese leaders have recently publicly acknowledged the importance of trade surplus reduction. Both Vice Premier Wu Yi and Minster of Commerce Bo Xilai have pledged to reduce China's trade surplus in 2007. Chinese officials have acknowledged the undervalued yuan as part of the problem and have been taking small steps to address the issue. But, clearly, much more must be done regarding their currency.

How much is the yuan undervalued? Without a market for that currency, we just don't know, but estimates are generally in the 20% range, some more, some less. The best measure of the amount of upward pressure on the yuan is the value of the foreign currencies – mostly dollars – the Chinese government has to buy in order to suppress the yuan's value.

In 1994, when China devalued its currency against the U.S. dollar from 5.8 to 8.7, its global currency reserves were only $30 billion. (China held the yuan at 8.28 from1995 until July 21, 2005.) In the twelve years from 1994 to 2006, China has spent $1 trillion to keep the yuan from rising, reflected in their accumulation of foreign currency reserves.

To put that in proportion, that amount is about 40 percent of China’s total annual production of goods and services – GDP. That is a tremendous distortion of trade and of China’s economy.

Even with the yuan’s 6.5 percent increase since July of 2005, there has been no letup in the growth of China’s foreign currency reserve increases. China is continuing to accumulate foreign currency reserves at a rate of about $20 billion a month. Once that rate slows sharply, the value of the yuan will be seen as closer to clearing the market.

The NAM recognizes that China cannot move to a floating currency at the present time, but there can be significantly more appreciation and flexibility using the current mechanism. Our goal is to see the currency moving closer to what a market value would likely be, with the eventual goal of a freely-floating currency.

This is not to say that progress has not been made – it has; but more needs to be achieved. Without greater progress, action could be taken that could do serious damage not just to our bilateral relationship, but also to our own economy and the world’s as well.

EFFECT OF YUAN APPRECIATION

Would a considerably stronger Chinese yuan have beneficial effects? Unmistakably yes. Yes for U.S. manufacturing; yes for global imbalances; and yes for the Chinese economy.

Our exports to China grew almost one-third last year, making China our fastest-growing large market. Last year also marked the first in a long time that China’s imports from the

United States grew faster than China's imports from the world. Did the revaluation of the yuan so far play a role in this? I don't know for sure – but it certainly did not hurt. And continued yuan appreciation would certainly contribute toward maintaining or increasing the rate of growth of U.S. exports to China.

The huge U.S. trade deficit with China is continuing to grow. When final data are in for last year, it will be seen that the deficit with China was about $230 billion. But even here something may be happening, as the deficit grew 15 percent, compared with an average increase of 25 percent in recent years. Now I am not implying that this is great news, but it is the first time we have seen a slowing in the growth rate of our deficit with China. Here again, it is possible that the currency's revaluation is beginning to have some influence.

It is nonetheless true that many NAM member companies have indicated that the appreciation so far is not large enough to change matters significantly. Not infrequently, companies have told NAM staff that a 15 percent shift could change their competitive situation dramatically. Others say their problems go beyond that.

Some commentators have stated that Chinese wages are so low that no amount of currency appreciation would make a difference. They overlook the fact, however, that labor costs are only one factor in the production process. U.S. manufacturers are highly efficient, with strong labor productivity. In fact, Census Bureau production data show that production worker wages and benefits on average are only 11 percent of the cost of U.S. manufactured goods – with 89 percent of the production cost being materials, energy, overhead, marketing, distribution, profits, taxes, and the like. We do recognize that U.S. manufacturers need to work with our own government to make the U.S. manufacturing environment a competitive one. However, the idea that low Chinese labor rates trump all is not true.

The undervalued yuan is also having an effect on the currencies in the rest of Asia. A number of key Asian countries, including Japan, Korea, Thailand and Malaysia have all publicly stated their concerns about their competitiveness with China given the yuan's current value. They are all basically looking over their shoulders at the Chinese, fearing that China's controlled currency could destroy their competitiveness globally. This is also spilling over and having negative effects on negotiations in the Doha Round.

So we have now arrived at the point where everyone agrees the yuan needs to appreciate to address serious global imbalances, even the Chinese government. It is no longer a matter of if, but when – and how rapidly. This matter of timing is very important, as the U.S. government has been meeting with Chinese officials for over three years on this issue. Frustration is growing and support for free trade is waning.

THE TREASURY REPORT TO CONGRESS

Treasury's Report to Congress has a role in this process. The NAM has consistently called on the Treasury Department to cite China for currency manipulation, as discussions have seemed to bear little fruit. We were encouraged by the Treasury Report of May 2006 in which Secretary Snow stated that: “China's rigid currency regime has become highly distortionary…The current system poses a risk to China's economy, its trading partners, and global economic growth…if current trends continue without substantial alteration, China's policies will likely meet the technical requirements of the statute for designation. China is now ready and should move without delay in a manner and magnitude that is sufficiently reflective of underlying market conditions.” Secretary Snow basically got the ball down to the one yard line and put China on notice that significant progress had to be seen in order to avert citation in the next report.

The NAM has believed the citation of China under the Treasury report should be viewed as a positive step, similar to citing countries, including China, under the “Special 301” reports the U.S. Trade Representative produces annually with regard to intellectual property rights protection. Citing a country for currency manipulation would not in itself compel a change, but would provide a strong and highly visible signal that the U.S. Government believes it is important for the currency to change.

Citation under the report is also an important signal to the International Monetary Fund, which has surveillance of international exchange rates as one of its primary functions. IMF officials have already noted that it would be incongruous for it to cite China for currency manipulation if the U.S. Treasury says to the contrary.

Failing to cite China under the currency report mandated by the Trade Act of 1988 has undermined public confidence that the U.S. government is leaving no stone unturned to move China's currency. It doesn't contribute to a sense of fairness in global trade to point out that the Chinese currency is undervalued, they must do something about it, but if they don't, we can't or won't do anything about it.

In contrast to the May report, the last Treasury Report in December 2006 was virtually silent on China. We understand fully and did not criticize the Administration for doing that. It was not possible for Secretary Paulson to start working within the new Strategic Economic Dialogue (SED) to engage China on changes to its economy and currency and then immediately return to Washington and cite them for currency manipulation. I think the Congress shared that view as well.

With regard to the next Treasury report, due in the first half of this year, it would be premature to speculate what will happen in the coming months or what the report will say. Secretary Paulson asked for time to let the efforts made at the SED to work. We will certainly be following progress on this issue and revisit it mid-year.

STRATEGIC ECONOMIC DIALOGUE

Mr. Chairman, you also asked me to comment on the Strategic Economic Dialogue (SED) and I would be happy to do so. The Strategic Economic Dialogue is an excellent idea. One of the most important aspects of the SED is working with top Chinese officials to foster the understanding that the shift from an export-led economy to a domestic-led economy must take place more rapidly, and that a more realistic currency valuation is an important part of that process.

Progress through mutual consultations is always the preferred method. It is important, however, that China not view the establishment of this dialogue as an excuse not to move more quickly on its currency.

We hope that the SED will help shift the balance from those within the Chinese government who feel that China must move slowly on its currency, to those that understand a more rapid appreciation is necessary to achieve internal domestic and international goals. It should be acknowledged that the 6.5% appreciation we have seen in the yuan is welcome movement. But China's trade surplus continues to grow globally and its export sector continues to boom. It is important that in our dialogue, U.S. officials continue to stress the need for greater movement.

In September 2006, Secretary Paulson addressed our Board of Directors and indicated that the Chinese currency issue was a top priority in his work with the Chinese government in the SED. At that same Board meeting, we considered whether or not to support legislation that would make currency manipulation subject to U.S. countervailing duty law. The majority of Board members, after discussion, decided not to support this legislation. There are those who have indicated that this lack of support indicated that the NAM has backed off from the currency issue. That is not the case.

The Board felt that the bill would not move the Chinese government nor was it likely to provide effective relief for affected companies. It is important to note, however, that the Board was unified in stating that the Chinese currency was a concern and that progress needs to occur, as indicated in my earlier quote from the Board statement.

The Board called for the creation of a board-level U.S.-China Task Force to work with the Administration and Secretary Paulson in particular on SED issues, especially currency. This task force comprises executives from companies spanning the whole spectrum of views on how to approach China's currency.

I chair this Task Force and, in early December, we met with Secretaries Paulson and Gutierrez and U.S. Trade Representative Ambassador Schwab prior to their trip to Beijing for the first SED meeting. In our extensive meeting with Secretary Paulson, we made it very clear that manufacturers wanted to see significant progress in the appreciation of the yuan or we risked actions that could do serious damage to our bilateral relationship. We came away convinced of his determination to get the job done, and an understanding of his particular approach.

The Board also stated that while time is given for this approach to work, many NAM members can make a credible case that they are being harmed seriously by unfair trading practices on the part of Chinese exporters. The Board noted that this situation is particularly serious for smaller firms that are unable to utilize costly U.S. trade remedies to obtain relief. As a result they called for an effort to find ways to make trade remedies more readily available and affordable to smaller firms.

CONCLUSION

In conclusion, I would like to point out that China is one of the most important factors in world trade and will only become more important as time goes by. We as American manufacturers must take advantage of the opportunities offered by the large, emerging market in China, as well as be adaptive and innovative to maintain our competitiveness globally.

However, confidence that our government will insist that our trading partners live up to their commitments is extremely important. No other factor can distort trade as much as currencies that are manipulated to establish artificial advantages in trade. An exchange rate reflecting market forces would shift the competitive equation so that some Chinese industries would remain extremely competitive, while others would find their artificial advantage diluted. U.S exports would also grow more rapidly, helping to bring about a more sustainable trade position.

We applaud Secretary Paulson for his efforts in the Strategic Economic Dialogue and the NAM China Task Force will continue to work with the Administration to ensure that China's currency more accurately reflects the strength of the Chinese economy and provides U.S. manufacturers an opportunity to compete on a level playing field.

We also applaud this Committee's interest in China's currency and in seeing that all major currencies are market-determined. The NAM thanks you, Mr. Chairman, for holding this important hearing, and we look forward to continuing to work closely with you, other members of the committee, and the committee's excellent staff.