CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE

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"REFRAMING CHINA POLICY" CHINA'S TRADE POLICY

DEBATERS:

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MODERATOR:

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JESSICA T. MATHEWS: Ladies and gentlemen, if I can interrupt your luncheon conversations and welcome you to this sixth in the Carnegie Reframing China Policy Debate Series. It's a great pleasure to have you with us. For those of you who are with us for the first time, this is a – this series is an effort to bring together the most informed and most interesting minds – experts on China, both to try to get the fact straight and to sharpen policy options.

As I said, this is our sixth get-together. We have dealt with the sustainability of the Communist Party in China, the sustainability of China's very high rate of economic growth, the significance and meaning of its military modernization, the issue of human rights, and China's interests in eliminating the U.S. as a regional power in Asia. So the debate series and subsequent ones in this series cover the whole range of political economic security issues.

If you have missed any and would like to see them, you can both read and hear and see them at www.CarnegieEndowment.org/ChinaDebates. Today's session returns to the issue of economic policy, and deals, as you will hear, and as you know, with the question of China's violations of international commercial norms, and whether or not they demand a vigorous response.

We have two distinguished debaters who our even more distinguished moderator is going to introduce. We have an economist and a lawyer and a moderator who is both. Although, Bob, I guess you also count as an economist.

ROBERT B. CASSIDY: Yes, but not a lawyer. (Laughter.)

MS. MATHEWS: And our – before I turn to our moderator, I do want to express our deep thanks to Senator Lugar for making this space available to us, and to the GE Foundation, our corporate sponsor, for making this whole series possible. We are very indebted to them.

Our moderator for this afternoon, who will set the framework for this discussion and introduce the speakers, as well as moderating the debate with you, is, as I mentioned both a lawyer and an economist. He is chairman of Swiss Re American Holding, and until very recently, vice chairman of the U.S. Federal Reserve Board. He is also a very distinguished trustee of the Carnegie Endowment, for which we are very grateful.

Roger Ferguson, thank you so much for being with us.

(Applause.)

ROGER FERGUSON: Jessica, thank you for that introduction. And let me also add my welcome to Jessica's. As you know, this is one of the Carnegie Debates, and our motion today is put into debate form. Resolved: China's trading partner should take immediate steps to address China's violations of international commercial norms.

Now, I will shortly introduce the pro and con – those taking those two sides, but before I do this, I want to just emphasize a point that Jessica made: which is that while we are clearly very much in the debate format, the goal is to adduce the facts. The facts may be complicated and quite nuanced, but they should be put on the table. And the reason to do that, obviously, is that will then sharpen the policy options.

The other element to make clear is something that all of you well recognize, which is that the U.S. and China are already both competitors and colleagues in many different ways in the global scene. That is likely to continue for several generations—and so, all the more reason to get the facts put on the table.

Now, as Jessica has already indicated, we have two superb and respected specialists who are going to help us out here: Albert Keidel, immediately to my right, and Bob Cassidy, sitting to my left.

Bert here, started off his career with a Ph.D. in economics from Harvard I believe, which I will say immodestly, is not a bad place to start. But more importantly, he is now a senior associate of the Carnegie Endowment for International Peace, where Jessica leads the troops and I am one of the trustees. He specializes in China's economic issues and related U.S. policy.

He, as both of our speakers do, has some government background. Until 2004, Bert was with the U.S. Department of the Treasury's Office of East Asian Nations, first as acting director, deputy director, and then also as China desk officer. So he is really seeing this from the ground up. Before that, he was a senior economist at the World Bank, working in their Beijing office, and as you can imagine, has strong Mandarin reading and speaking skills. He will take the con side of the argument.

For the con – yes, you are. (Laughter.)

MR. FERGUSON: It's helpful that the debaters know which side they are going to take. As I said, you will take the con, Bert; trust me.

Bob Cassidy, sitting further to my left, is the director of international trade and services for Kelley Drye Collier and Shannon. Previously, he was appointed as assistant U.S. trade rep for China in 1997 and was the chief negotiator on China's 1999 market accession agreement with the U.S. for China's accession to the World Trade Organization, the WTO. He has hosted a number of other such agreements throughout Asia, and so he comes also with a wealth of experience.

And so let me start now with the pro side. I think – should we do it that way?

MR. KEIDEL: I'm going to go first.

MR. FERGUSON: You want to go first? Okay. We'll have Bert do the con side first, and then we'll reverse the order at the end. So, Bert, the microphone is yours.

MR. KEIDEL: Thank you, Roger. And it's an honor to be at the same podium with Bob Cassidy. We have got two topics today really. One is the validity of these claims that are made against China, and the other is the question of what are appropriate U.S. actions.

When we talk about the validity, I think we have to balance two fundamental concepts. One is the letter of the law. That is, what do bilateral and multilateral agreements bind China to do? The letter-of-the-law approach is rooted in criminal-and-civil-justice traditions of developed economies.

The other concept leads us to ask what kinds of things is China realistically capable of accomplishing in any given time frame? Now, this concept requires understanding of China's actual capabilities and is rooted in analysis of economic development processes for poor countries. Now, I know you can roll your eyes and either one of those depending on your position, but we need to consider both points of view.

On appropriate U.S. actions, the critical question is, if the letter of the law says China must come into compliance, what is a reasonable process by which process can be expected to come into compliance? Most importantly, I think we must distinguish Chinese practices and U.S. remedy efforts that are part of everyday business-as-usual, which is fine. And what goes beyond business-as-usual and requires treating China as if it is outside this perimeter – that would be a very serious matter.

I am going to brush quickly over four topics that are important in current Chinese U.S. commercial relations. One is China's currency; another, intellectual property rights; a third, countervailable Chinese subsidies; and a fourth, the role of Secretary Paulson's strategic economic dialogue. I think we can all agree that documentation of claims against China must be of high quality, and the choice of actions must promise a credible chance for progress at the maximum pace possible. We cannot tolerate flimsy or weakly argued assertions, and we cannot tolerate actions on our part which themselves undermine our credibility and undermine international organizations on which orderly international commerce depends.

I will show that the most serious claims against China are poorly reasoned and sometimes even flimsy arguments. And I will demonstrate that dramatic, unilateral U.S. moves in these cases would undermine progress in just these areas and harm vital U.S. interests at the same time.

Let me turn to currency manipulation. This is a very popular and attractive story that China keeps its currency cheap that makes all of its products cheap. The problem is that, as you examine all of the analytical reasons – and there are many of them – not a single one stands up in the face of critical analysis. The first of course is easily dismissible. It says, well, the bilateral surplus that China has with the United States is very large and has been large for a long time. We all recognize that you don't judge an exchange rate on any bilateral relationship. You must look at a country's total trade with the global community.

On China's total trade: Yes, it's true that just in the last two-and-a-half years, China's surplus has grown very large, but nothing happened to the exchange rate to make that occur. The key point here from an economic, analytical perspective is that many powerful forces can affect a trade balance's short-term move within one, two, or three years. The exchange rate is just one of them. And its potential is dwarfed by changes such as those that China is experiencing as it enters the WTO.

So we need to say there is also an asymmetry in the WTO accession. In started with a surge in creation of export platforms, because even before China acceded to the WTO, investors after the U.S.-Chinese agreement realized that China would be freed from the uncertainty of annually showing that it could have most favored nation status with the United States. So, export platforms invested in by foreign firms and by Chinese firms began before China even acceded.

The import side has come more slowly. So I maintain we cannot judge how these powerful forces will balance without waiting quite a while – and I would pick 2010 as perhaps a logical framework.

Mirror stats that some claims use are clearly exaggerated. They say they take into account Hong Kong trade by looking at what other countries are trading with China, but they ignore Hong Kong's re-exports to China, and that is why they come up with the results that they do. What about these famous models? You get major economic institutes with models that are designed, sadly, to only ask this question: What exchange rate change would it take to affect China's trade balance? And, surprise, they come up with a large change in the exchange rate as necessary to balance trade.

There are other questions: Reserves are accumulating rapidly. But those reserves increased very rapidly because of speculative moves in what is a circular process in which the U.S. government is pressured to pressure China to revalue. Speculators put more money in China. Reserves go up – more pressure. It's a spiral upward. And in recent years, China's trade balance has also contributed to it.

When we look at what a country's reserve should be, we have to balance it against their money supply. And China has a huge money supply. If it ever wants to open up its capital account, it needs to have large reserves.

Finally, does intervention itself in foreign exchange markets show manipulation? No. Intervention is vital for countries all around the world to help maintain some stability, and China is no exception. And the IMF rules do not say that intervention is proof of manipulation. And I will also say – we can ask this in the question period, but I maintain this from looking at detailed analysis of China's macroeconomic cycles – it does not have export-led growth. All of China's cycles are led by domestic changes. And the big proof of this is that in the U.S. boom in the late-'90s, China's growth slumped. And as the U.S. entered recession in 2002, China had already taken off. So this image of China as a currency cheater is unwarranted, and any draconian or dramatic reactions on our part in a policy sense are totally uncalled for.

On intellectual property rights, it's very important to notice that China, like many developing countries, has violations of property rights, domestic and international. The capacity of their legal systems, their administrative systems, their police, are quite limited. We like to think that China can snap its finger in Beijing and everybody jumps all around the country. That is not the way it works. There is limited capital that the central government can use to accomplish things that go against the grain of local commercial interests, and IPR is no exception.

What would work in action? The kinds of things the U.S. Chamber of Commerce in China is doing, which is to work with local governments to strengthen their capacities. But if the U.S. comes in with draconian steps, that undermines the credibility of those efforts and slows down their progress.

What about subsidies and countervailing duty? For a long time … I testified in 1982-83, leading up to the Commerce Department's decision of '84, saying that China has so many non-market forces – and they still are in existence today. But for anybody to identify one or two of them as a subsidy that justifies a countervailing duty is unwarranted.

And, I would also maintain that in this particular case that I have looked at carefully – the glossy paper case, the arguments, sadly, are very flimsy. They point to interest rates for bank loans in China as being much too low. They picked that [interest rates] out of a whole range of problems that these enterprises face, including party directives to hire more people and fees and taxes they have to face. They admit it's very difficult to do, but as an interest-rate test, they go to other countries, over 50 of them, and they average them. But they average nominal interest rates. They throw out a few like Brazil because their interest rates were over 50 percent. Why? Because inflation was very high.

So when they come up with a standard of 15 percent for short-term rates that includes inflation in all of those countries, that is a false standard by which to measure China. You have to use real interest rates, and that is what this claim has not done.

So in countervailing duty, they should use anti-dumping measures. That is what they are there for, and, therefore, cases, when you cannot measure a subsidy, and that is still the case for China. So to pile on, on top of antidumping measures, countervailing duties is clearly hitting twice and is not fair.

I would say, does China have a non-market economy? Yes. And one of the reasons is because it's growing very fast. They are not counting on market forces to creep along, just as we didn't count on that when we recovered from the Great Depression during World War II. Instead, we have forced this economy forward knowing where we needed to go.

Take steel. China's per-capita steel production is one-third of South Korea's. Does China need a lot of new steel capacity? You bet it does. Are they going to get there if they just see, well, maybe this quarter, what do our steel profits look like? No. Is that a non-market capability? It sure is. And therefore, can you really judge the steel sector as a countervailing duty? No, no way.

How about saying, well, this exchange-rate problem warrants a countervailing duty for all goods coming from China, into the United States. That is also clearly unwarranted given the analysis we have heard.

Let me conclude by saying the strategic economic dialogue of Secretary Paulson should not be a deadline enforcing agency. Our governments are badly mismatched. Counterparts are not real counterparts, even though they look like they are. Two, three, four agencies in one side, and two, three, four different agencies in other side need to talk to each other if we are going to solve a whole range of problems as two countries that we have going forward, and that ought to be the focus of this dialogue. It should not be hijacked to try to pressure China when cases are as flimsy as they are. Thank you very much.

MR. FERGUSON: Thank you.

(Applause.)

MR. CASSIDY: Okay, can you hear me? Am I okay? My voice doesn't carry so well so it's – I worked with the people back there to make sure that it would carry. Could I first put this into perspective from the way I look at it as a former trade negotiator. The U.S.-China relationship has been one that is governed by – at least on the part of China – by two things: its drive to assume its rightful place in the global community -- the economic and political community -- alongside the United States. I saw that time and time again in trade negotiations.

And the second thing that is driving it is the struggles of bringing in a non-market economy,as Bert has said, into an international arrangement that is based on market principles. It is essential in the WTO that market principles work because it's those market principles where concessions by this group of countries over here, is going to move to benefit for those countries over there. It is a critical component of the whole WTO system. That is the context with which we are dealing. And China entered into the WTO on that basis.

I would like to raise four points. First of all, China is violating its WTO obligations and for commercial advantages. Second, the United States needs to take action not just for itself but for China and for the whole WTO system itself. The United States also does not need to implement extraordinary measures to do this. There are tools within the WTO mechanism, within the accession agreement with China, to achieve that end. And the failure to do that means that the United States is going to be giving up its leadership role in the global community.

On the first issue, let me deal with some of the issues that Bert dealt so eloquently on: currency, IPR subsidies, and I'm going to add in there industrial policies as well. When we began investigating this, almost all economists – in fact, every economist that we found, found that China's currency was undervalued by 10, 15 percent – I'm sorry; it ranged from 10 percent to 90 – 75 percent – a huge range. More recently, let me just say that Fred Bergsten, in testifying before the Hill, came up with a number of about 35 percent. Robert Samuelson in the post came up with 40 percent. Even Alan Greenspan in Asia was saying that China's currency is undervalued. Clearly it's undervalued.

I don't want to go into the elements of trade flows, et cetera, but when you calculate the trade deficit, based not on China's numbers but on trading partner's numbers – and you can do that – you come up with huge surpluses on the part of China, even when you take into account re-exports through Hong Kong and also freight and insurance differences. Clearly the currency is undervalued. And what does that mean? That means that exports – China's exports are subsidized, imports are taxed, and investment flows are encouraged because it's cheap money. I say to my clients, go to China; it's cheap; it's to your advantage.

On IPR, China joined the rules on IPR actually well before it entered the WTO. China has the laws in place; that is not a problem. China doesn't enforce it. The EU, the United States, we tend to use criminal and civil laws in courts to enforce them. China has the right and indeed under the WTO, to use administrative measures. And that is what it has used because its court system is not up to, say, international standards, the standards that would be necessary. But unfortunately, when applying those administrative measures, it's a slap on the wrist. They are pennies compared to the damages that are done. So in effect, it's not enforcing the laws that it has. Once again, this is a critical component in trade for the United States because this is where our comparative advantage is.

In the area of subsidies, China said that it was going to inform the WTO of all of its subsidies when it joined. It didn't do so until last year, and that is when we found subsidies that are prohibited, that they are providing subsidies, and they are prohibited under the WTO. That is why we are taking it to the WTO, because of their own statements.

Every country in the WTO is subject to anti-dumping and subsidy laws. And so it's not – China should be treated no differently. And on industrial policies, what we are seeing in China – and this is what the chamber and the NAM and other organizations are finding, is that China is using industrial policies to affect commercial relationships. The telecommunications example, the encryption standards is just one example. They are trying to use those standards to force us suppliers to go to Chinese sources.

My second point, it's in the interest of all – of not only the United States but China and the WTO to be more agressive. It's in China's interest because these international rules essentially represent an international rule of law. So as China's system is evolving, at least on commercial relations, we have an international rule of law that is being applied, and it's being applied by a WTO standard, by arbiters and by that forum. So this is critical in demonstrating that the rule of law should apply. It's important for U.S. interests because these are – these are our economic interests, our trading interests.

The actions of the United States is not protection; it's defending what our interests are. Manufacturing jobs have declined. They have – over the last few months, they have continued to decline despite the rise in jobs. All the jobs that are being created are in non-tradable sectors. This is having an impact specifically on the manufacturing sector of the economy.

And third, it's important to the global trading system. If the United States doesn't take action, who is going to take action? And the WTO depends upon the system working efficiently and that the rule of law applies. And it has to apply to the largest countries that are members, and China is one of those.

We have the tools to take concerted action. Right now, we have been using dialogue, and it started off with the JCCT. It went with the enhanced JCCT, with Ambassador Zoellick, secretary of Commerce, and then State CoucilorWu Yi. It's now elevated to the Strategic Economic Dialogue.

In point of fact, the dialogue has not resulted in much beyond agreements and understandings. But when you look at the results, the actual impact, there is nothing there. Look, for example, at the results of the 2006, JCCT results: No beef exports to China, despite the agreement that this market was all opened. And that is according to the USTR's national trade estimate report. China agreed to lower the registered capital requirements for foreign telecom providers – that hasn't been done. China also committed to issue technology-neutral telecommunications standards – not done.

You can go on and on. Almost all of the results – they are very good on paper, but in practice, they don't result in anything. What does result in progress is assertive action. We saw that when the United States took China to the WTO in various measures, China reformed some of its practices to reduce the burdens on the WTO case that they had, and to improve their position.

They respond to positive action. The first enhanced JCCT was probably the most productive one, and that was productive mainly because USTR promised that they would deny the labor 301 petition and the currency 301 petition. Congressional actions do make a difference, even the Schumer-Graham legislation resulted in China appreciating its currency and going to a basket of currencies because of fear of passage of that law.

So there are actions that are available, and the United States can take them. These are all fully within the WTO system. The key thing about these measures that can be taken is that the measures that are taken are actually measures that protect U.S. producers of these products. And so they are the ones that are going to benefit from it. These are not actions that are necessarily draconian in any sense. Put aside Schumer-Graham for example. The Ryan-Hunter bill, for example, are measures that are fully consistent with the WTO.

So what I would say is that there are plenty of tools that are available that have not been used to deal with these important issues. China does respond to those measures, and the United States needs to take action, otherwise the global system will not function properly, because it's not going to have the rule of law, and thus markets will not work.

These are critical components, and as we have seen in the cases that have come to the WTO, nearly all of the cases have come from the United States, where other countries have joined, but it has to be the United States that is going to stand up to China, and that is because China's objective is to stand next to the United States in the global arena. And so if the United States doesn't take action, China is not going to move. Thank you very much.

(Applause.)

MR. FERGUSON: Bert, Bob, thank you both very much.

Let me just say one thing about format. We will now have about 20 minutes in which I will ask each of our participants' questions, hopefully to sharpen the debate a little bit. You have at your tables, I believe, pieces of paper. Please use this period to write down any questions that you might have after the 20 minutes in which the three of us have a little dialogue or trialogue. We will then for 30 minutes turn to your questions and answers. So hopefully by the time it's over, all of the relevant facts will be on the table.

Let me start with Bert. Bert as I observed – obviously it is very hard to prove the role of currency in the relative supply and demand of international goods,, and in the surplus. But I would have to ask Bert as an economist, one to another, what role does currency play? You seem to suggest that currency is irrelevant and think the broader forces are really driving. But certainly, currency, which drives relative price, must have something to do with the current account surplus that China is running right now vis-à-vis the U.S.

MR. KEIDEL: Sure. Currency is important because why is one exchange 3,000 to one U.S. dollar and another is 125 to the U.S. dollar? The rough parity in terms of pricing levels between different countries are cleared up by an exchange rate in a rough way. But to try to link an exchange rate to short-term moves in prices or to short-term moves in exchange rates fails econometrically. There are some famous theories. Samuelson Balassa, and others. And if you try to look at the literature on whether these are successfully proven or not, they run into the difficulty that other forces overpower them in the short term. But in the long term, absolutely currency plays an important role.

And so I would argue that – give us some time. If it turns out that then market forces become available – because remember, China has a close short-term capital account. Market forces are not operating on this exchange rate. And if they did allow short-term capital flows, they wouldn't be in; they would out. And you would therefore have a lot of downward pressure on the Chinese currency.

Where it would sort out? Very difficult to say. But the balance of trade in a short term, under these circumstances, is not the right market test. The broad average of what a currency's relationship is to another currency is generally fundamental to economics, but not the short-term variations.

MR. FERGUSON: Okay, so we agree the currency is fundamental for the longer term, but not the shorter term. Why do you think 2010 is the right year as opposed to 2012? I think I heard your focus on 2010 as the year in which we can get a better handle on this.

MR. KEIDEL: 2012 would be – I just think we have to look at what has sorted out in terms of China's compliance or movement into the direction of opening up its imports. For example, the whole ASEAN+3 process in which there is going to be more of a free-trade arrangement with Southeast Asia will have a dramatic effect overpowering exchange rate issues. Where is that balance going to work out? Very difficult to say. We have seen, as China has opened up its trade regime since 1978 the currency has basically devalued in real term, much faster because the currency rates that existed in the early 1980s were wholly inappropriate for an economy that eventually opened up in the '80s and then even more in the '90s, and now even more in this century.

MR. FERGUSON: Okay, one last question, and then I'll turn it over to the other side. How would you describe, for the benefit of our audience, the exchange rate regime in China? Is it free-floating, is it fixed, is it something else? You obviously don't want to use the word manipulated because that has important ramifications.

MR. KEIDEL: No, it can be manipulated, just not for unfair trade advantage. If you intervene, you're obviously manipulating your currency to keep it stable, in particular, or as stable as possible to allow an orderly revaluation or devaluation, one that doesn't disrupt normal commercial operations because it's the uncertainty of lots of volatility in a country where you don't have hedging capabilities because of the lack of sophistication, where you don't have futures markets that are really operating very well – some conditions like that where stability is really important to support orderly trade.

And so for poor countries, you often find a pegged rate. And the IMF says a pegged rate is a legitimate, you know, operating process, but to keep it level, you need to intervene. And intervention by itself is not illegitimate.

MR. FERGUSON: Bob, let me pick up on that point. What is the distinction, for the audience, between intervention, which I gather is okay, and manipulation, which isn't? How do we know it?

MR. CASSIDY: Well, let me just go back to the some of the points that Bert made because the assumption he is drawing here is that these are all short-term phenomenon. I disagree with that. I think this is something that has started a long time ago. In 1992, China unified and depreciated its currency by 50 percent. And since that time, we started to see a movement of jobs throughout Asia to China. That was the beginning of the problem. The Asia financial crisis, all of the other Asia countries had to depreciate to come into alignment with China, and that has continued it.

So this is not just a short-term phenomenon that we are seeing. We are seeing since that time that – just using the foreign exchange research, we have seen that China's foreign exchange reserves have continued to grow and even accelerate over this time period. So this is not a short-term phenomenon that is taking place now.

Now, with respect to manipulation versus intervention, indeed, in the early part, before China initiated a, quote, basket of currency methodology for floating its currency, China did intervene in the marketplace in order to keep the peg the way it was. So in a sense, that was an intervention in there. Was it manipulating? Yes, because it was maintaining an undervalued currency and the advantage was that it increased their exports.

Why did they want to do that? It creates jobs. The number of jobs that China has to create is monumental, just to absorb the population that comes in from the countryside, if nothing else. It has to have a growing economy. A depreciated currency does that because what it does, it increases investment in the economy. It increases jobs. They are all export-led-growth jobs, but that is what is happening. And its purpose is to manipulate it for that end.

Now, indeed it did. Go to a basket of currencies in – what was it, 2006?

MR. FERGUSON: 2005.

MR. CASSIDY: July 2005 – appreciated by 2.11 percent, I think, and then started to allow it to increase. And that increase was minor. This is one of the things that China does very well, that when pressured to do something, it makes small changes that are insignificant, that don't actually affect change. The reports that we get now is that the foreign exchange reserves in the first quarter of this year are double the rate that it has been in the previous first quarter. So it's growing about $45 billion a month. This is not a short-term problem; it's a long-term problem that has been growing and exacerbating.

MR. FERGUSON: Right, but you still haven't quite gotten to the – I think the heart of the issue. It is absolutely true, as you say, that China at some point depreciated their currency. There is nothing, I think, in the WTO that stops the currency from depreciating. You may correct me on that. It's also true the reserves have gone up. But the point you heard from Bert is, and most economists would agree, there are a number of factors that are driving that relative growth – interest rates, a variety of things – the basic supply and demand internally for domestically produced goods. Many of those things are outside of the currency regime. So how do you know that it is the currency regime that needs to be the focal point here versus a variety of other factors, and how do you know that the currency has been manipulated as opposed to being diminished?

MR. CASSIDY: Well, I'm not too – this is one of the difficult things I think in being able to ascertain directly what is happening. How is it happening? China does intervene in the marketplace. There is no doubt about that because it has to in order to maintain the currency at the rate that it does. When you talk about manipulating, what you're talking about is, what is the intention? Isn't that what it is in essence. And, you know, you – unless a government is fully transparent, that the U.S. tends to be, and Europeans tend to be, you can't really be able to ascertain exactly what the intentions are, and even then, it's not always clear.

But, you know, the effect is – if you look at the effect and what the impact is -- that it gives them a comparative advantage. And thus, you know, their exports keep growing. We talk about our exports growing to China, but they are still small in comparison. You know, I think you look at manipulation by the impact on what it has. And thus far, I would say that you have to measure it somehow, and that would be by growth of foreign exchange reserves – by trading partner data to estimate what is happening on the current account, on merchandise trade. I think these are the ways that you have to be able to ascertain what manipulation is.

MR. FERGUSON: Okay, let me go now to the next issue, since we have clarified that one – (laughter) – and the question of intellectual property. Let me start with Bert. Bert, as I heard it, you basically said these things happen. That may be a bit of parody of what you said, but it didn't hear sort of a strong move. What is your policy recommendation on the question of intellectual property? I think most people would say there does seem to be an issue, as broadly as you described it – not just China, but more broadly.

MR. KEIDEL: There is an issue with every developing country in the world stealing copyrights, modify – when I was in Taiwan, I used to eat Rich crackers in a box that looked just like Ritz crackers, but it was Rich crackers. And they tasted pretty much the same, and they were dirt-cheap. Publishing around the world rips off developed country books. It's an issue that you can say partly they don't want to face it, partly they don't have the legislative and administrative capabilities. They may have the laws on the books, but do they have the clout to actually carry it out in the face of economic interest at the local level?

And third, do they have the political cohesion to be able to risk that kind of pressure within their own country? And so these problems are not just with China; they are around the world. And countries like China are suffering horribly from their own intellectual property right violations. Adulterated infant formula, a whole range of drink and soft-drink problems that are killing people and making them sick. So these are – so it's hard to say, well, they just don't care about these things. It's not just that it's an international trade issue, or an issue of protectionism; these are fundamental capabilities that every country has difficulty governing.

And so we're right, and my policy recommendations are to come up with very specific cases that are well documented and pursue them through business-as-usual channels. Those are not extraordinary, sudden, forceful actions, but through business-as-usual channels. At the same time, find a way to help the Chinese strengthen their own institutions. And we have been doing that across the board, but in a very shallow way.

So my recommendation is to remove restrictions for U.S. assistance to China. Right now, USAID and a number of other aid programs are prohibited from helping China, prohibited from helping China develop the institutions that would aid American firms trying to do business there. That prohibition should be removed by the Congress as soon as it can.

MR. FERGUSON: Okay. Let me just push you on one thing. You used the word, "business-as-usual channels." What does that mean?

MR. KEIDEL: Well, I would say that, the topic of our debate is: "Are immediate forceful steps required?"

MR. FERGUSON: Right, and you mentioned that as no, so –

MR. KEIDEL: And I'm saying business-as-usual steps are fine. And so that is, using the WTO – new steps, yes; bring cases, but they ought to be well-documented, not like this countervailing-duty case, for example, that has these flimsy sort of pumped up charges about certain interest-rate differentials that completely ignore economic fundamentals by talking about nominal interests rates around the world as some sort of standard against which to judge. It ought to be real interest rates. These are really serious – they hurt American credibility.

So our steps need to be credible and they need to be gauged so that we don't undermine American interests because the Chinese will happily buy from Europe and Japan if we end up doing things that gain sympathy around the world as being out of proportion. So I would argue for proportionality, business as usual, using procedures that may take some time, but that strengthen international institutions.

Don't preempt with unilateral U.S. steps either through the Congress or through the administration that – ways that, for example, immediately impose penalties and then have them tested in the WTO, when we're pretty sure, and a lot of people are pretty sure it's not going to fly. That has happened, and that really damages our credibility; it damages our ability to create stronger working relationship with China, and it damages international institutions.

MR. FERGUSON: Now, what I heard from Bert is a couple of things. China is a large country; they want to fix things. In the Chinese phrase, "the mountains are high, the emperor is far away." In other words it is very hard for the central government to manage this. That is one of his arguments. The second argument I think I heard is quiet diplomacy will work. And the third is we should help build institutional capability in China. What is wrong with those three?

MR. CASSIDY: The issue is in essence, business-as-usual. Indeed, IPR problems extend throughout the world. There are differences, though, between, a country like the Philippines or Thailand and China because of China's sheer size. We cannot treat China as a, "a developing country." As the Argentine representative to the WTO said, the WTO is not about poverty; it's about competition. And so consequently, every country needs to be held to that standard, not to the standard that they are a developing country or that they need to have some unusual rights. And point of fact for the smaller countries that don't affect the trading system that much, it isn't quite the same, immediate issue, but with China it is. Why is that so?

What we see in imports from China arecounterfeit products that are coming into the United States – 80 percent of the seizures made by customs are from China. Last year it was 69 percent. So this is increasing. And they are almost all coming from China. The problem is that, for many of the counterfeit imports that we are seeing, we're seeing that these are hazardous – as Bert pointed out, these are pharmaceutical products with no active agreements. These are with toxic active ingredients in them. These are brake pads made of sawdust that are used on school children's buses. These are true stories. These are flammable products that are – flammable fabrics, not inflammable – flammable fabrics that are used in children's apparel. These are the things that we are seeing coming into the United States, and that is what is being seized at the port.

So these are hazardous. It's hazardous to the United States, to other countries, such as malaria drugs and other things. It's also hazardous to China. China has the ability to enforce its laws, even if it just relies on administrative measures. It can do this. And by having those penalties, the pirates, the counterfeiters, will be stopped at the border before doing these things. We should institute, when we see seizures, higher levels of inspection for products coming into the U.S. market. Why should we be allowing, for example, the melamine dispute? It's not an IPR issue, but it's symptomatic of the type of problem that we have.

This is a question of competition, not development. This is not poverty. Yes, they need to change their laws, but we need to take steps that are going to first protect the U.S. market from those products, and second of all, drive the Chinese to implement the changes at a faster rate than what they are now. Dialogue does not result in fast progress – lots of agreements, but not in real progress.

MR. FERGUSON: Okay, hypothetical: the Chinese move. They put on, let's say, the kinds of penalties you're talking about, yet we still find improper goods coming to the U.S. economy. No one wants that to happen. I'm not quite sure necessarily that what you proposed really works. I mean, we need to hear I think a little more clearly in such a large rapidly growing economy what is that we can be doing in addition to the kind of things we're talking about, because it's not clear that those will necessarily work.

MR. CASSIDY: What, that increased seizures won't work? Seizures at the border – and increased level of seizures by customs at the border will have an impact on trade. And that is what China is going to respond to. If the United States does this, other countries will do it as well, because we've seen in the past that once the United States does something, other countries follow in our footsteps because they hide behind the United States, or at least follow behind the United States.

So the things that the United States has a cumulative effect on China, and China responds to that. That's why dialogue is – there is no cost to dialogue; it just means setting up another meeting. That's the only thing – and that results in little progress. Assertive action is what is necessary to create the dynamics for China to change, along with dialogue, I would say, is not necessarily bad, but it just doesn't result in the progress that we want to see.

MR. FERGUSON: Okay, let me close because I've got just one more minute of my own time here. On this question of dialogue – useless? Much more talk? Or, are there some real teeth there? What would you recommend to the Secretary of the Treasury, who has now raised this to a very high level, to handle the kinds of concerns that we heard from Bob?

MR. KEIDEL: The secretary of the Treasury, I believe, should take advantage of this wonderful opportunity. When I was in the Treasury, we tried to do this, but we had problems with the Chinese on agreeing who the counterpart was and it fell apart. This is as second grab at the brass ring, and it's being successful.

What he needs to do is resist efforts on the part of Congress to turn this into a disciplinary tool, a kind of a whip to get the Chinese to do very short-term things, and use it to help improve the match and the communications between agencies and the two governments that are mismatched. And I would go further and say that he needs to look at some of the longer-term issues and turn around and point the finger at American agencies and American legislation to say, China is a legitimate competitor, and as we look at the various ways that China competes with us, it's doing a lot of things right, it's got some problems, and we need to do business as usual in pushing those in the right direction.

But the United States needs to fully fund – the Chinese would love to have inspections if the border gets stronger. That helps them discipline their own problem back home. That's not some draconian measure that cuts off the Chinese from the international commercial system, but adding – making currency a dutiable or countervailing dutiable issue would, or just raising all tariffs 20 percent would, or introducing our own false phyto-health standards to try to restrict Chinese imports. This is the stuff of trade war. We do not want to move in that direction.

Instead, we need to use trade assistance adjustment. That needs to be fully funded. Congress likes to pass bills and then underfund them when they come to be run year after year after year. Let's not do that. And it's not just trade. You remarked about falling employment in manufacturing. Manufacturing output is booming. American manufacturing is growing dramatically, and it's part of our major export success in China, which has grown 150 percent in the last four years, and it's number four in the U.S. export market – against, you know, giants like Germany and Canada and Mexico.

So the issue is, technology is changing. That's why we're losing jobs. Where is the technology adjustment assistance? We need to make our labor force more mobile with pensions, health care systems, education and training that will make – that China should prod us to do. China is a chance for us to change ourselves at a pace which we otherwise wouldn't choose.

MR. FERGUSON: All right, one last question. Back over to you, Bob.

The fact that Bert hinted I'll put on the table. As I recall from my Fed days, manufacturing employment in this country as a percentage of employment peaked in 1970 or '72. We have faced a long, long decline of manufacturing employment as a percentage of total unemployment. To pick up Bert's point: not being driven by China. Your argument?

MR. CASSIDY: Well, there are a number of factors that are driving this, and surely structural changes are taking place in the U.S. market. Services are becoming a greater share of GDP. When I started work, trade was 5 percent; now it's 33 percent. We've seen that trade is a much more important element.

On the manufacturing side we're seeing that these structural changes are influencing job growth. However, it's not to say that just because there are structural changes that China's economy isn't affecting us as well. Once again, when you have an undervalued currency and you have all these companies – and, you know, we all know this is taking place, all these companies moving to China – then we see that not only are the producers of products moving but they're asking their suppliers to move to China. When we see all of these trends taking place, then, you know, we – you know that it's having an impact on production.

I'm not so sure and confident about the rise in manufacturing that is taking place. For example, Dell Computer – all the computers that are shipped in the United States are produced in the United States, but all of those parts, all those components are made in China. And so, you know, how much of this increase in manufacturing is actually U.S. manufacturing as opposed to products that are being assembled even in the United States that are really not U.S. products? So I have my doubts about those manufacturing statistics.

Structural changes are taking place, but the impact of the currency alone is having an enormous impact on the manufacturing as well because of the exodus of jobs – exodus of manufacturing to China.

MR. FERGUSON: Okay. Let me now turn to your questions. I'll try to read as many as I can get through. I think this one is aimed I think a bit more towards Bert, and the question fundamentally is, suppose the renminbi, the Chinese currency, the yuan, were to float. Are you certain that it will appreciate? And I can turn this to both of you. There is a real argument that it might depreciate as Chinese individuals purchase assets abroad, selling the assets they have in the Chinese economy. So what would happen if China were to float? Let me turn first to Bert.

MR. KEIDEL: Well, you would have to say what other things are happening. For example, does China open its short-term capital flows at the same time that it floats the currency? Boy, then all bets are off. I think if you maintain non-market forces like a closure or a managed short-term capital account and then say let the renminbi go where it goes, you won't get a market result; you'll get, probably, appreciation until it gets to a certain point where speculators think it's time to unwind their positions, and then you'll see it go the other way for a while because there is a lot of hot money that's sitting there waiting until they can get it up to a certain price, and then they're going to leave again.

And so it's very difficult to say, but I would say fundamentally, the idea of a float as moving in the direction of a market solution is invalid as long as you have serious violations on actions on some parts of the market, in particular capital flows.

MR. FERGUSON: And I think I also heard that if they had a free capital account for convertibility, you're not really sure which way the currency would move.

MR. KEIDEL: You would see, because of the limited options to Chinese household investors and corporate investors, very low deposit rates in the banks. You would see a lot of money moving out to be invested in New York, and even more in Hong Kong, but they are now – that's restricted; that's managed. It's happening on a small scale, but it would be very large, and it would be sucking sound going out and then there may be a sucking sound coming back in, and where it would settle I think it's very hard to say.

MR. FERGUSON: Okay, so the answer to the question is, free float may or may not lead to appreciation depending on –

MR. KEIDEL: Things you do.

MR. FERGUSON: – what are the things you're doing, particularly with respect to the capital account.

Let me then turn over to you. You've been pushing, obviously, for greater flexibility. The question here is how much could the Chinese currency appreciate without harming the Chinese economy enough to hurt U.S. interests?

MR. CASSIDY: Yeah, I'm not going to get into predictions of what the numbers would be, but if it was truly floating, I think you would see that the currency would appreciate. In fact, when you look at all the statistics, that seems to be where the money is going now. The money is going into China now because they expect an appreciation of the currency. I know some of my clients prefer to keep their money in China because they want to see the yuan appreciate – or they don't want to see it, they're expecting it to appreciate.

So I think at the current time you're going to see an appreciation. When that would change, I don't know. I think Bert is absolutely right; you're going to see some going in, some going out, and at what point does it change that – and I don't know what that would be -- but there would be a significant appreciation.

MR. FERGUSON: Bob, let me push the question because the nature of the question is, can the Chinese appreciate their currency without harming their economy enough to hurt the U.S. interests? So the question was pushing you on the cyclical dynamics of an appreciation of Chinese currency – which presumably you want – potentially being dangerous to the U.S.

MR. CASSIDY: A depreciation could be –

MR. FERGUSON: And appreciation could be –

MR. CASSIDY: – is dangerous to the United States? Well, that's true, but my argument is that in the short-term, yes, an appreciation of the yuan is going to have an impact on the U.S. economy as well. Products are going to be more expensive in the United States that are generally exported to the United States, so it will have an impact on the United States.

Other currencies, however, will not have to appreciate as much if the yuan appreciates, so consequently there is going to be some adjustment in the trade flows with other countries – Canada and the European Union, for example. So it's really difficult to say where it would come out.

Failure to deal with the foreign exchange situation, with the exchange rate, also has its problems. What crisis is that going to create for the global trading system and the global financial system? China is – its increase in industrial capacity is phenomenal. Some of the over-capacity figures in steel that Bert mentioned – China feels that it's not producing enough steel, but global over-capacity is phenomenal. Automobile production, once again, is in over-supply globally.

So what we're seeing is a global glut of production that is taking place, being fueled by China's economy. That in itself presents a certain number of instabilities to the global trading system, global financial system. So there are dangers on both sides. The question is how can we get China's currency up to a level that would be something relatively balanced and sustainable over the long term?

MR. FERGUSON: Okay. A question I think you've already both answered: People argue that low-priced Chinese goods are helping the U.S. economy. I think I heard you, Bob, say that in fact if the Chinese price of goods were to go up, that would be harmful. So, I think you're supporting this view. And I assume, Bert, you would say the same thing. Are we getting some benefits as consumers for low-priced Chinese goods?

MR. KEIDEL: Well, they are, and it's not just a Chinese phenomenon; it's a global phenomenon, that if we forced the revaluation of the Chinese currency, some of those goods would be produced again in Vietnam or they would be produced in the Philippines or Thailand or in India. And so you have to say that a whole share of the world's labor force that's literate and eager to work hard for a standard of living much lower than ours is acquiring early skills in the industrial revolution with early technologies. The U.S. forte needs to be in advanced technologies and high skills. That's our future, not to try to hold onto blue jeans production somewhere in the Southeast United States.

MR. FERGUSON: Okay. Let me continue with the currency and then go to the IP questions just to get them all bunched together. I think this is addressed to you, Bob. It says: What would a WTO consistent currency manipulation case look like? So what does a case look like? What does somebody have to prove? How will they know it when they see it?

MR. CASSIDY: In fact, a number of cases have been filed with USTR Section 301 petitions. What they allege is that an undervalued currency – China's manipulation of the currency to undervalue it -- is a prohibited export subsidy. This was not perhaps the intention of the negotiators but the way they defined a subsidy meant that currency manipulation does constitute a prohibited export subsidy. Now, mind you, there are very few areas in the WTO that prohibit something; export subsidies are one of those. And so that's one of the principal arguments. Ironically, that argument came from China, not from the United States.

The second argument is it's a violation of Article 15 of the WTO, and that is that the currency is being manipulated for commercial purposes. And then you get into a whole range of other articles where it affects bindings and WTO nullification and impairment and a whole host of other provision. I would say that the two WTO arguments that are the most compelling are the article on prohibited export subsidies and the Article 15 of the GATT '95 on currency manipulation.

MR. KEIDEL: If I could just respond quickly, I think the process question is the WTO would take the question of whether or not there is currency manipulation and whether or not currency actions amount to a subsidy and give them to the IMF to decide, and the IMF uses the same criteria that the Treasury Department uses, and this is a very – and you can read on the Treasury website how they go about it. And you don't just look at intervention, you don't just look at trade; it's such a complex issue that going back to the 1970s they've worked out what the standards should be and what the principles are.

And both of these – the Treasury has found China manipulated the currency, but it was back before 1994, before the unification. China had a duel exchange rate. That's manipulation. But after the unification in '94 – and by the way, after that, China had 40 percent inflation, so the real currency appreciated enormously. The nominal one is a red herring. But the process would be to go to the professionals, and that's what we're getting right now already, that decision.

MR. FERGUSON: Bob, two more for you and then one for Bert. Quote, "Mr. Cassidy says the difference between manipulation and intervention is, quote, 'intent.' Can we really base policy on such subjective analysis as intent?"

MR. CASSIDY: Well, there are a number of areas that I think do have intent in there, and that would probably be one of them. You know –

MR. FERGUSON: But I think the nature of the question is can we in some sense risk the possibility of a trade war with a major trading partner, based on something as subjective as intent?

MR. CASSIDY: Well, you know, I'm not so sure that – you may not be able to evaluate intent, but you can do effect on it, and what the impact of it is, and apply intent there. But, you know, for the most part, the arguments on – you know, that is one of the weaknesses of the provisions under Article 15: Is it intended to be for commercial purposes? The impact certainly is for commercial purposes. But that's why the argument of a prohibited export subsidy is so compelling because you don't even get into that issue of intent, is that it is a prohibited export subsidy and therefore it is prohibited under the WTO. So you don't have to get into that intent area.

This is the problem for Treasury, I think, and when it looks at its analysis of can we divine the intent of manipulation, and that's essentially what it is. And there were pieces of legislation that would take away from the concept of intent and make a much more objective analysis of whether there is effectively currency manipulation for that purpose.

MR. FERGUSON: Okay.

MR. KEIDEL: You know this better than I do, Bob, when you say this prohibited export subsidy. Does somebody have to first show that in fact there is currency manipulation to say that this is a subsidy? How do you know that it's a subsidy? If something is an intervention, that makes it a subsidy? or – (cross talk) – make it a subsidy?

MR. CASSIDY: Because of the government – it's a government transfer. The government purchases the dollars for yuan at a certain exchange rate, and that's where the government transfer takes place.

MR. FERGUSON: How would you distinguish between stabilizing intervention, which a lot of developing countries find a need to do, and something that turns out to be an export subsidy?

MR. CASSIDY: Well, other countries would be subject to this as well to the extent that it was significant. This would be – this is a new area, I confess, but it would be something that would have to be looked at, and that's why I think the Treasury wants to have a more rigorous IMF review of exchange rates. It's because of that.

If the currency is being undervalued for the purposes – not for the purposes but effectively is undervalued, then it can be considered a prohibited export subsidy under the rules of the WTO.

MR. FERGUSON: Okay. One more for you. We've got to be mindful of time, but it says, Bob: U.S. applied antidumping laws to China based first on the assumption that China is a non-market economy. Then they applied countervailing duties based on the fact that China is – or the assumption that China is - a market economy. Don't you think U.S. is stuck in this contradiction, or do you see this as being consistent?

MR. CASSIDY: Antidumping is a methodology, is one of comparing essentially prices, and therefore essentially you have to be able to determine what is a market price. And the methodology that China agreed to in its WTO accession was that you could use other methods of calculating what a market price would be. Subsidies are not necessarily based on what that price is. Some of them are; some of them are not. But some of them can be just direct transfers from the government.

So there are a whole range of different subsidies that apply, but they're not necessarily price based. And so, consequently, subsidies can apply, and they do, in other countries. They apply – in all other countries you can use subsidies and antidumping. The difference is if you apply both, then you have to separate – make sure that they, to a certain extent except in one small area, that they don't overlap.

So that's the distinction that is made, but it's not necessarily a price comparison as it is in antidumping with respect to subsidies. It's a fact of is there is a government transfer; does it create injury?

MR. FERGUSON: Okay. Let me turn now away from the economics questions to the intellectual property question. I've got two related, both to Bert basically, and the question effectively is: Look, you say the central government can not enforce its will when it comes to these intellectual property issues. But both of these questioners say at this stage, you do not find, for example, any counterfeit Olympic goods in China because the Chinese government has made it quite clear that it will not tolerate knocking off Olympic products, and such things will be punished severely. Apparently the same thing is true for domestic movies in which the piracy rate is much lower than for other movies. So they have the will to enforce IP when they want to. How do you respond?

MR. KEIDEL: Well, they have limited capital to spend in that area. And what can they do – how much can they impinge on local economic interests is a big question. I've been, last year, in various parts of China, and I saw what I thought – well, you get far away from Beijing – in Beijing it's very strictly enforced on these products for the Olympics, but you get in other parts of outlying Hunan or some other areas, I thought I saw – I mean, I didn't go buy them; this is not my idea of a souvenir to take home – but it looked to me like some knock-offs. But I would like to see someone that's gone around the country and found evidence on the Olympics.

On films, film distribution is centrally managed in China, and there may be a better enforcement at that local level. I doubt it. I mean, I don't know how you measure that. But I will maintain strongly that there are some things that are technically perhaps easier to govern, but by and large, for a whole range of intellectual property – whether it's Chinese software, whether it's Chinese medicines, they have serious problems disciplining that throughout the country, and they don't have the mechanisms, the clout, the reach or the political ability to do so.

MR. FERGUSON: Okay. This is the flip side – I think aimed more to you, Bob, but just basically the last point that Bert made is also the one in this question, which is in fact it does seem that Chinese IP interests are being damaged to some degree. Doesn't that really prove that maybe the Chinese government is not as influential as one would think? Or, the other side of this question, why isn't this Chinese IP difficulty having more impact and faster? So it's sort of the flip side of Bert's point.

MR. CASSIDY: I didn't catch the first one. I'm sorry.

MR. FERGUSON: The first one is the following – and it picks up on Bert's point – which is it does seem that IP is influencing China as well – a point that he was making in terms of drugs, et cetera. The fact that damage to China's own IP interests exists, doesn't that seem to prove the Chinese government is not as influential as you would like in managing IP questions?

MR. CASSIDY: Well, as I said, like Bert, I cannot tell you that they are dealing with Chinese products, like motion pictures, differently than they do foreign products. I don't know that for a fact. It may be true, and someone in the audience may know – have specific examples of that.

It is absolutely true that protection of intellectual property rights is important for China, and I think the leadership does know that. But the Chinese leadership also knows that if it clamps down too hard on the IPR piracy, it affects employment. It affects its relationships with its local governments and with all the other various entities. But, you know, I'm sorry, that's too bad. You know, why – you know, all of these – the failure of protecting intellectual property rights is creating hazards around the world. It's a safety issue. You know, if you have malaria drugs that have no active ingredients being shipped to Thailand or other countries, this is a hazard around the world. And I'm sorry; I feel sorry for them that it takes more political will to deal with that. But that is a serious problem. They can fix these problems by greater monitoring at the border so at least they don't export it, or countries are affected by putting our own restrictions at the border to prevent this from happening.

So it's not just a question of motion pictures and sound recordings, although that tends to get the biggest play. These are health hazards that are affected, and it affects virtually every product that is traded. And so it's important for China to deal with this as much for its own interests as for our interests, and it has the ability to do it. It can do it; it controls all the ports. There is not one port that China – that the central government -- doesn't control. And if it were the Falun Gong, you can be sure that they would enforce that.

So they have the political will to enforce things; the question is, is that their priorities are not there, and that's for employment and for internal political reasons. The only way to fight that is to provide an external force or pressure that will create the needed pressure for that reform. Dialogue is not it.

MR. FERGUSON: Okay. There are some more questions but we're running out of time, so I'm afraid I'm going to have to cut off the Q&A with the audience at this stage. We're now going to give each one of our debaters four minutes for concluding remarks, and we'll start with Bob.

MR. CASSIDY: From here?

MR. FERGUSON: Wherever you feel most powerful. (Laughter.)

MR. CASSIDY: Once again, I think, you know, there are differences on the seriousness of the issue, but what I'd like to raise is that we have at stake international obligations that are at stake, that countries – that we have an international system here under which the trading system and the global economy has been able to grow. It depends upon countries abiding by the rules. The United States, China, all of the countries have to abide by these rules in order for it to be effective, in order for us even to generate support for this round of trade negotiations that are going on.

The failure of a large country like China not to implement the rules or to use the rules in ways that distort trade to its advantage undermine the global trading system and potentially the international financial system.

These are the issues that are at stake. The United States has always used dialogue as a method. I have been one of those that were at the forefront of that dialogue, of every month spending a minimum of two weeks in Beijing on dialogue. It's not that it is not useful, but it has to be balanced with a more forceful, a more assertive use of tools that are there are in the WTO, that were negotiated in the WTO for this purpose, and some of them specifically for China. And the inability to use these tools means that we're not going to hold China to the same standards that we want to hold every other country to.

Once again, this is not an issue of poverty; this is an issue of competition. It's an issue of discrimination. And that's what we're dealing with China. Whether it's on IPR or whether it's on currency, subsidies, industrial policies, we need to have someone stand up to China. And really, my experience was that China only listened to the United States. I wish it were different. I wish the EU were in a position to play a stronger role, that Japan were able to play a stronger role, but the facts are that currently China listens to the United States, and the inability of the United States to take that leadership role, or the unwillingness of the United States to take that leadership role, means that China is not going to be held to the same standards and the global trading system is suffering. Not only that, but U.S. industries suffer as well.

MR. FERGUSON: Bert?

MR. KEIDEL: Well, it's been a pleasure, and I've learned a lot from Bob. I'll begin with my basic concept, that we're really looking at two approaches to foreign commercial policy. One is the approach of the litigant. There is the law; there is the letter of the law. I want to use that to the advantage of myself. And you will therefore get actions based on the letter of the law.

The second perspective is, what will work? What will get us results as fast as possible? And that takes a perspective that includes the capabilities of the country that you're addressing. And in this case, in China's case, that – any poor country, you have to say, what is that capability? I would make the remark that China's political system is a unitary corporate structure; it's not a federal system. If someone wants to discipline a local government in China, they have to go through that local government unless they want to send a special taskforce. The United States, if you have trouble with Chicago's police, the FBI can do something about it, under the direct control of Washington. China doesn't have that kind of system.

And so it seems counterintuitive, but when you have a corporate structure, you should think you could get things done, but just because they have a corporate structure, it's tougher to do things, and they don't have the regulations for disciplining at the local level.

I think the discussion about health standards is vitally important, but it's not an issue that requires a trade war with China to solve. We should spend more. It is a question of capability. The Chinese need to spend more at their ports. We need to spend more. The FDA is woefully underfunded for a lot of these kinds of inspections. They get very little money compared to, say, the Department of Agriculture for a lot of its inspection work, but the FDA, for pharmaceuticals and so forth, very, very weak grant increases in the U.S. budgetary system recently.

I would also make a very strong case that we think very carefully and pull back from extraordinary steps, particularly ones where the Congress is micromanaging how one approaches a very complex issue like the currency. It's very attractive, and in many ways it appeals to freshman economics to say the prices moves here and you get an equilibrium, but that's not the way it really works. There are many other powerful forces, and I would just encourage us to realize that the forces are changing dramatically in our trade relationship with China, and swamping, for the time being, whatever price effects might be significant.

And I would also encourage the Congress to look at China's challenge as a legitimate challenge, one that has its shortcomings, and they require what I call business-as-usual pushback – but not extraordinary measures that threaten the relationship. Those are ones that work within channels that we've established well.

Instead, look at where the United States needs to go to really improve its competitiveness. Congress is already doing that in the areas of education. But in so many other areas, we need to move ourselves ahead with a leap of the kind we made perhaps under the threat of World War II's invasions, but this is not a military threat; this is a commercial and a cultural threat. And I think in this regard, we can work with the Chinese and therefore the dialogue is essential, particularly in the way that the strategic economic dialogue has organized it, with multiple agencies for both sides under a single leadership, and I encourage them very much to stick to the medium- and long-term problems that we all face.

Thank you very much.

MR. FERGUSON: Good. Thank you, both. Bert Keidel, thank you. (Applause.) Bob, thank you. (Applause.)

Let me thank the audience. I think the organizers probably want me to draw your attention to something that's in your program. The last of the Carnegie Debates for this season – "China's Role as a Responsible Stakeholder" – is on June 11th –

MR. : June 11th, correct.

MR. FERGUSON: – June 11th, so please mark your calendars. And I'll leave it to you to decide who won this debate. I would say, broadly speaking, we've created more light than heat. So in that sense, it was successful and everybody won. So thank you all very much.

(Applause.)END