

CHAPTER 2
CHINA IN THE WORLD TRADE
ORGANIZATION: COMPLIANCE, MONITORING,
AND ENFORCEMENT

“WORLD TRADE ORGANIZATION COMPLIANCE.

The Commission shall review China’s record of compliance to date with its accession agreement to the WTO, and explore what incentives and policy initiatives should be pursued to promote further compliance by China.” [P.L. 108–7, Division P, Sec. 2(c)(2)(H)]

KEY FINDINGS

- China has made some progress in formally meeting its WTO accession commitments, but compliance shortfalls persist in a number of areas of key importance to the United States. While China has generally reduced tariffs in accordance with its accession commitments, it still maintains nontariff barriers and is erecting new nontariff barriers that harm U.S. interests by effectively limiting market access for U.S. goods and services.
- China continues to tolerate rampant piracy of copyrighted U.S. material, with rates running above ninety percent across all copyright industries for 2003.¹ This will cost U.S. industries an estimated \$2.6 billion in lost profits in 2004.²
- U.S. companies are sometimes forced to transfer technology to Chinese partners as a condition in business deals. The Chinese government violates its WTO obligations when it expressly requires technology transfers as a condition of doing business. It is also able to compel such transfers through use of its regulatory powers as well as its extensive role in the economy. These technology transfers pose substantial economic and security concerns for the United States.
- China has frustrated the effectiveness of the WTO’s Transitional Review Mechanism (TRM), thereby preventing it from becoming a robust mechanism for assessing China’s compliance and for placing multilateral pressure on China to address shortfalls. The TRM is a central element of China’s WTO accession arrangement, and its failure to perform as intended is a serious policy concern that demands attention. China has taken deliberate actions to make the TRM process meaningless and thus must ultimately bear the blame for the TRM’s failure. However, the United States and other WTO members are also at fault for allowing the marginalization of the TRM.
- The U.S. government has established mechanisms for monitoring China’s WTO compliance but has not been sufficiently vigorous in enforcing U.S. trading rights under U.S. and international trade laws. This insufficient enforcement may dissuade U.S.

businesses from filing trade complaints or safeguard requests, making the use of such measures even less likely. Other potential trade remedies against unfair trade practices, such as countervailing duties, are not being applied to China despite requests by U.S. companies.

OVERVIEW

China was not a market-based economy at the time of its accession to the WTO nor is it now. Because the structures of the WTO rely on the functioning of market-based economies, China's accession required a unique agreement allowing China's early entry in exchange for firm commitments to implement a broad range of legal and regulatory reforms as well as tariff reductions. China also agreed to special safeguard mechanisms that other WTO members could utilize to protect domestic industries significantly injured by surges of imports from China's nonmarket economy. Assuring that China implements its WTO commitments is a large and important task for the U.S. government.

Given the complexity and significance of China's WTO commitments, both the U.S. government and the WTO have established monitoring processes to assess China's compliance progress. At the multilateral level, the WTO's TRM is the central monitoring mechanism. The monitoring systems were also intended to serve as early warning indicators allowing parties to resolve potential disputes. However, they have had only mixed results in this regard.

The focus of the Commission's work in this area has been evaluating the record of China's compliance with its WTO commitments, investigating possible avenues by which the United States can encourage and facilitate improvement in Chinese compliance, and assessing the effectiveness of WTO and U.S. processes for compliance monitoring and enforcement.

The Commission held a hearing on these topics on February 5, 2004. The hearing featured executive branch officials; trade law experts; and representatives of agriculture, business, industry, and labor organizations.

Further, the Commission contracted with the Washington, DC, law firm Stewart and Stewart to produce a comprehensive report, *China's Compliance with World Trade Organization Obligations: A Review of China's 1st Two Years of Membership*. This project is a follow-up to Stewart's April 30, 2002 report for the Commission, *Accession of the People's Republic of China to the World Trade Organization: Baseline of Commitments, Initial Implementation and Implications for U.S.-PRC [People's Republic of China] Trade Relations and U.S. Security Interests*.

A Commission delegation undertook a fact-finding mission to the WTO's Geneva headquarters in December 2003 to discuss with WTO officials, U.S. officials, and representatives of other member countries their perspectives on China's first two years of membership in the WTO. The effectiveness of the TRM process was another central topic of discussion.

ANALYSIS AND FINDINGS

Transitional Review Mechanism Proves Ineffective

As part of its accession agreement, China agreed to be subject to the TRM, a multilateral annual review of China's compliance with its WTO obligations. The TRM is scheduled to produce annual written reports for the first eight years of China's WTO membership, with a final report after the tenth year. It has produced two reports to date.

Congress specifically sought the TRM as part of China's accession agreement, in part because U.S. negotiators expected the TRM to be a robust mechanism for monitoring China's WTO compliance and applying multilateral pressure for improvement.³ Because the United States was assenting to China's entry into the WTO before its economic and regulatory systems were consistent with WTO norms—i.e., before China had become a fully developed market economy—the United States sought a method for accurately measuring China's implementation of WTO commitments as well as a process for encouraging China's compliance with its obligations. In practice, the TRM has been undermined by China's refusal to abide by standard WTO procedural norms. For instance, China has generally refused to respond in writing to requests for information from other member countries as part of the process. China has also resisted WTO member efforts to have TRM issues raised in WTO subsidiary committee meetings at a sufficiently early stage to have a meaningful dialogue regarding member concerns.

In its report on U.S. efforts to monitor China's WTO compliance, the U.S. General Accounting Office (GAO) concluded: "The TRM process fell short of the meaningful review hoped for by U.S. and other country officials. U.S. government officials agreed that the TRM process would have worked better if there had been greater consensus from WTO members on their expectations regarding China's actions."⁴

China argues that the normal customs of the WTO do not apply, because the TRM is a discriminatory measure applying only to China. The Commission notes that China's entry into the WTO was conditioned on China's acceptance of the TRM and other provisions intended to compensate for the disjunction between WTO standards and China's nonmarket economy. China is therefore obligated to participate in the TRM in good faith, notwithstanding the TRM's application solely to China.

U.S. trade representatives urged China to cooperate more fully following the first TRM report cycle. After experiencing similar noncooperation during the second report cycle, however, the Commission understands that U.S. officials opted not to press the issue on the grounds of hoped-for progress in bilateral dialogue. The Commission expresses deep skepticism regarding such an approach and believes that U.S. officials should press to make the multilateral TRM process more effective.

The Commission is also concerned about the minimal coordination that exists between the United States and other major trading partners regarding China's compliance. The European Union (EU), Japan, and others have not worked together to formulate a joint

strategy. Instead, they appear to be waiting for the United States to challenge China on its failings.

China's Compliance Record

China's Obligations

As part of its accession agreement, China was obligated to implement the following salient measures by December 11, 2003:

- Reduce tariffs on most imported goods to rates bound by the WTO accession agreement—this commitment has generally been fulfilled according to schedule.⁵
- Grant full trading rights—the right to import and export—to foreign minority- and majority-owned joint ventures—despite some changes in regulations, this commitment has not been fulfilled.⁶
- Grant distribution rights to foreign minority- and majority-owned joint ventures—this commitment has not been fulfilled.
- Ease geographic restrictions on operations of foreign financial services companies—this commitment has been fulfilled according to schedule.
- Implement a transparent tariff-rate quota (TRQ) system in certain agricultural products—some improvements were made, but problems remain with the nature and transparency of TRQ regulations.
- Permit foreign majority ownership in joint venture retail enterprises and open a number of additional cities to retail joint ventures—this commitment was only partially fulfilled, with foreign investment still problematic in some sectors.
- Permit the use of commission agents for the sale and distribution of the products of foreign majority-owned entities—this commitment has been partially fulfilled, with restrictions remaining.
- Allow foreign majority ownership, and place no geographic or quantitative restrictions on foreign service suppliers of most imported and domestically produced products—this commitment has been fulfilled.⁷

Further commitments to reduce or eliminate barriers to trade, particularly in the area of trade in services, are due to be implemented by December 11, 2004. These commitments relate to such services as commission agents' services, franchising, wholesale and retail operations, telecommunication, banking, insurance, and securities.

China's Compliance Shortfalls

In a series of reports, the executive branch has documented in detail the extent to which China has complied with its accession obligations and other applicable WTO standards. Moreover, Congress has directed the GAO to conduct a multiyear, comprehensive assessment of China's compliance record and U.S. monitoring and enforcement efforts.⁸ China has completed a broad range of tariff reductions and legal revisions in accordance with its accession agreement. It has also improved its tariff-rate quota system for agricultural imports and somewhat reduced capitalization requirements for financial service operations.

However, China has also erected new barriers to trade. Additionally, a number of key unaddressed compliance shortfalls continue to significantly impede U.S. trade with China, such as:⁹

- continued direct and indirect subsidies to Chinese producers, including preferred and sometimes unserviced loans from state-owned banks, and free or discounted utility services;¹⁰
- rampant abuse and lax enforcement of intellectual property rights;¹¹
- poor transparency in adopting and applying regulations;¹²
- the use of unjustified safety standards to exclude foreign products—including non-science-based sanitary and phytosanitary (SPS) standards on agricultural products and the China Compulsory Certification of safety;¹³
- the use of unjustified technical standards to exclude foreign products or force foreign producers into joint ventures with Chinese firms for production aimed at the Chinese market;¹⁴
- denial of equal tax treatment to foreign products;¹⁵
- barriers to specific services, such as financial services and express couriers;¹⁶
- obstacles to domestic distribution of products by foreign companies, which severely curtails the ability of foreign companies to gain market share and forces them to sacrifice control over portions of the profit margin;¹⁷ and
- forced transfers of technology in return for market access or other regulatory approval.

The Commission is particularly concerned about instances in which transfers of technology are required by the Chinese government or state-owned and state-invested enterprises as a condition of establishing a business presence in China. Prior to China's accession, forced technology transfers were a customary part of doing business in China. China agreed to end the practice of government-forced transfers as part of its accession commitments, but the Commission understands that the practice continues.¹⁸ One less direct method for inducing technology transfers is China's use of its licensing power in coordination with its state-owned enterprises to organize bargaining cartels in technology markets.¹⁹ Additionally, because the Chinese government remains extensively involved in the economy, it is in a position to exert pressure toward technology transfers beyond the effects of normal government functions. For example, if a Chinese state-owned or state-invested enterprise requested a technology transfer as a condition of a business deal, the U.S. company involved may be informally told that its broader business dealings in China will be impacted by a refusal to accept this condition. Though it is only a violation of China's WTO obligations if technology transfers are an express condition of the Chinese government for doing business, the Commission is concerned with the cumulative effects on U.S. economic security wrought by transfers of U.S. technology to China.

Reports on Compliance Concur on China's Inadequate Record

U.S. officials, business groups, and analysts have commented on China's mixed compliance record. In 2002–03, agencies of the U.S.

government, the WTO, and a number of U.S. business organizations published studies and submitted testimony assessing China's compliance. The picture that emerges from these reports is that China's record of compliance in its second year in the WTO remains inadequate.

USTR's December 11, 2003, annual report to Congress on China's WTO compliance identified areas in which China had made progress in tariff reduction and implementing certain services and agricultural trade commitments, but concluded:

Despite these gains, 2003 also proved to be a year in which China's WTO implementation efforts lost a significant amount of momentum. In a number of different sectors, including some key sectors of economic importance to the United States, China fell far short of implementing its WTO commitments. . . . [I]nstitutionalization of market mechanisms still remains incomplete, and intervention by Chinese government officials in the market is common.

The USTR report highlighted the following concerns as of the second-year anniversary of China's WTO accession:

Agriculture

- unreasonable rules on biotechnology, notably in the case of soybeans
- questionable sanitary and phytosanitary measures
- apparent use of agricultural subsidies to promote exports
- improper administration of TRQs for bulk agricultural commodities

Intellectual Property Rights

- rampant piracy of film, music, publishing, and software products
- infringements of pharmaceutical, chemical, infotech, and other patents
- counterfeiting of consumer goods, electrical equipment, automotive parts, and industrial products

Services

- transparency problems
- excessive capitalization requirements for foreign financial services companies
- regulatory discrimination in express delivery services
- requirements for insurance companies to form subsidiaries in order to establish branches

Value-added Tax (VAT)

- VAT policies that encourage domestic production over imports in a number of industrial and agricultural sectors
- VAT rebates to domestic semiconductor and fertilizer exporters that disadvantage U.S. exports to China—and third markets—of these products

Transparency

- uncertainty, lack of uniformity in inviting public comment on draft laws and regulations and providing WTO enquiry points

Trading Rights and Distribution Services

- partial implementation of commitments required to be phased in over first three years of WTO membership.

U.S. business groups that lobbied hard in favor of granting Permanent Normal Trade Relations (PNTR) status to China in 1999-2000, and applauded China's entry into the WTO, are now expressing concerns over the pace and scope of compliance. The U.S.-China Business Council, in a recent article, concludes:

*... two years into China's WTO membership, the PRC government has been slow to implement its most significant commitments, and no progress has been made in some important areas. China has fallen into a pattern of renegotiating its WTO entry terms line by line as questions arise about implementation problems. China's interpretations of certain WTO terms violate the spirit, if not the letter, of its commitments, and new barriers China has erected in some areas make matters worse. ...*²⁰

The American Chamber of Commerce in China writes in its 2003 White Paper:

*... there is increasing dissatisfaction with the slow pace of implementing some of China's WTO commitments. As detailed in the relevant sections of this White Paper, there has been little progress in sensitive areas such as financial services, agriculture, and distribution. It should therefore be no surprise that American firms express greater dissatisfaction with WTO implementation than was the case last year, and a higher degree of skepticism about the intentions of the Chinese government.*²¹

The U.S. Chamber of Commerce has called China's WTO compliance "uneven and incomplete," noting further that

*[u]nless this picture improves, there will be an increasing crescendo of complaints about China's record. A number of companies already publicly express the view that China is dismissive of global trade rules and commitments. ... [W]e have not seen enough new contracts, new access, and new customers to stem this tide.*²²

The National Association of Manufacturers says its members

*want the United States to have a positive trade relationship with China. However, they also want a level playing field for competition. In that regard, we are hearing increasing concerns about unfair Chinese trade and currency practices and China's failure to provide the same kind of access to U.S. goods and services in the Chinese market that Chinese goods and services enjoy in the U.S. market.*²³

In sum, the Commission finds that though China has made progress regarding its accession obligations, significant gaps remain between commitments and practices. The Commission is concerned about these gaps for two reasons. First, they are affecting access to China's market for U.S. exports. Second, they augur poor implementation of remaining Chinese accession commitments that come due over the next few years.

Combating China's Compliance Shortfalls

The United States has responded to China's compliance shortfalls in four ways. First, it has made modest use of the trade enforcement mechanisms contained in China's accession agreement. Second, it has provided technical assistance to China to improve its implementation of WTO commitments. Third, it has engaged in bilateral dialogue to encourage voluntary reform. Finally, it has filed one WTO dispute against China. Overall, however, the U.S. government has not been sufficiently vigorous in addressing China's compliance problems.

China-Specific Safeguards Remain Underutilized

China's WTO accession agreement included several important safeguards that other WTO members could utilize to protect against surges of Chinese imports following China's entrance into the WTO. These safeguards are not designed to address compliance shortfalls. Rather, they recognize that nonmarket economies lack the necessary mechanisms to adjust production levels in response to changing market conditions. As a result, such economies have a tendency to flood overseas markets with the output from overproduction.²⁴ The safeguards against import surges were a key aspect of the WTO deal that ultimately made China's accession acceptable to U.S. negotiators and to the U.S. Congress.

- (1) The accession agreement allows WTO members to activate a safeguard against specific products imported from China when they cause a "market disruption" in the domestic market. The United States established a procedure for activating this safeguard under section 421 of the Trade Act of 1974. Cases are examined by the International Trade Commission (ITC), which in turn sends a report and recommendation to the president, who can reject an ITC ruling in favor of implementing a safeguard only on national or economic security grounds.²⁵ This safeguard is available through 2013.
- (2) In addition to the product-specific safeguard implemented through section 421, China's accession agreement provided WTO members with a special safeguard against market disruptions from Chinese textile imports. Activating the textile safeguard allows the United States to impose a limit of 7.5 percent on the growth of the offending category of imports from China. The textile safeguard can be activated for one-year periods and is available through 2008.

The United States has made only limited use of the available China-specific safeguards. One instance is the activation of textile safeguards in November 2003 on a limited range of products imported from China. Chinese imports in these textile categories,

which account for only five percent of textile imports from China, are currently subject to a one-year growth cap of 7.5 percent.²⁶ However, the U.S. government has failed to use these safeguards more broadly and did not even publish procedures for implementing the textile safeguard until May 2003, seventeen months after China's WTO entry—a delay that helps to explain the limited use of safeguards but also suggests policy inattention.²⁷ The textile safeguard will become increasingly important with the termination of the multilateral Multifiber Arrangement (MFA) at the end of 2004. The potential consequences of the imminent end of the MFA are discussed in Chapter 1.

The poor record of the United States on section 421 cases is detailed in figure 2.1. To date, the ITC has reached a determination in five cases and made three affirmative findings with accompanying proposed remedies.²⁸ The president has rejected each of the affirmative findings. The statute permits such a rejection only if broader national economic or security interests are cited.²⁹ Affirmative findings by the ITC in section 421 cases were intended to apply presumptively, thereby making the process an important tool for protecting against market disruption.³⁰ The Commission is now concerned that the effectiveness of the safeguards has been undermined by repeated presidential rejection of trade remedies in section 421 cases. Companies and organizations may cease to file legitimate petitions, given the significant legal costs associated, if they come to believe that even strong cases will be categorically rejected.

The Commission is concerned with the possibility that U.S. petitioners may have been given less access to government decision-makers on safeguard cases than Chinese respondents. The Chinese government has hired U.S. law and government relations firms to lobby the executive branch during consideration of safeguard requests.³¹ Representatives of petitioning U.S. firms allege that they were denied similar access granted to China's interlocutors.³² USTR has denied that section 421 petitioners had insufficient input or access to the executive branch during the process.³³

Figure 2.1 Section 421 Investigations by the U.S. International Trade Commission

Product	Investigation Initiated	ITC Vote on Market Disruption	ITC Recommendation	President's Response
Pedestal actuators	August 19, 2002	Affirmative; 3-2	Relief through quotas	Rejected recommendation on grounds of national economic interest ³⁴
Steel wire garment hangers	November 27, 2002	Affirmative; 5-0	Relief through additional duties	Rejected recommendation on grounds of national economic interest

Figure 2.1 Section 421 Investigations by the U.S. International Trade Commission—Continued

Product	Investigation Initiated	ITC Vote on Market Disruption	ITC Recommendation	President's Response
Brake drums and rotors	June 6, 2003	Negative; 5-0	Not applicable	Not applicable
Ductile iron waterworks fittings	September 5, 2003	Affirmative; 6-0	Relief through a 3-year tariff-rate quota	Rejected recommendation on grounds of national economic interest
Innersprings	January 6, 2004	Negative; 6-0	Not applicable	Not applicable

Source: Information derived from Stewart, *China's Compliance with World Trade Organization Obligations*, pp. 230-35.

Cooperative Efforts to Encourage Compliance

An example of technical assistance is the Department of Commerce's seminar program that educates Chinese officials about internationally accepted standards and the process for setting standards.³⁵ A 2001 U.S. government survey found nearly thirty federal departments and agencies engaged in capacity building in China.³⁶ However, the Commission has been unable to determine if these programs have been effective.

With regard to bilateral trade dialogues, the Commission suggested in its 2002 Report to Congress that U.S. trade negotiators deal with Chinese counterparts at the state council rather than the ministerial level and is pleased to see that trade dialogues are now taking place at this level. The United States continues to utilize the U.S.-China Joint Commission on Commerce and Trade (JCCT). China has elevated the level of JCCT talks by sending Vice Premier Wu Yi to the April 21-22, 2004, meetings. In addition to other ad hoc formal and informal meetings, the United States established the Trade Dialogue in February 2003, which brings together U.S. agencies and Chinese ministries.³⁷

China made several important promises at the April 21-22, 2004, JCCT meeting. If indefinitely postponed plans to implement its own wireless Internet standard, which would have acted as a barrier to trade and a mechanism for coercing U.S. companies to transfer proprietary technology. China also pledged to improve its enforcement of intellectual property rights (IPR) and to institute the next stage of market access reforms, as laid out in China's WTO accession agreement, six months ahead of schedule. The Commission notes these promises but remains skeptical in light of similar, unfulfilled promises in the past, particularly in the area of IPR protections. The Commission also notes that a number of important U.S. concerns were not included on the JCCT agenda, including China's exchange rate and labor practices and widespread subsidization of export industries.

The U.S. government has also recently made several organizational changes to address its growing concerns with China's trade

practices. USTR has established a new Office of China Affairs to “lead USTR’s effort to make sure the United States has fair and open access to China’s markets.”³⁸ The Treasury Department appointed Ambassador Paul Speltz to the position of economic and financial emissary to China.³⁹ The Commission hopes these changes will allow the government to better manage the U.S. response to addressing trade concerns with China.

The United States Files First WTO Dispute

The United States filed its first WTO dispute against China in March 2004 challenging its value-added tax on semiconductors, and the European Union and Japan joined the case as coplaintiffs in April 2004. China maintains a seventeen percent value-added tax on semiconductors but provides a rebate for sales of domestically designed and manufactured semiconductors, making the effective domestic tax rate three percent. Foreign-designed but domestically manufactured semiconductors are subject to an effective tax rate of six percent. China maintains these differential tax rates in order to force leading-edge semiconductor manufacturers to move production to China.⁴⁰ The United States believes that this practice violates the WTO’s national treatment principle and has entered into formal consultations with China as the first step in its WTO dispute. Informal consultations on the issue have been held since China’s accession, but they have ultimately proved fruitless due to China’s contention that its practices are WTO-consistent. How China responds to this case is an important test of China’s membership, and other WTO members appear to have been waiting for the United States to take the lead in confronting Chinese trade practices.⁴¹

The Commission believes that the United States has not pursued its trade rights sufficiently aggressively under either the WTO or domestic trade laws and that the time for restraint and forbearance has passed.

In addition to more vigorous application of China-specific safeguards and use of the WTO dispute resolution mechanisms, the United States should consider new options for inducing improvement in China’s trade practices. One option is to adjust U.S. practices or statutes to allow countervailing duties to be levied against nonmarket economies. The Department of Commerce currently labels China a nonmarket economy, a classification that U.S. negotiators worked hard to maintain during China’s accession process. Under existing Commerce rules, countervailing duties cannot be applied to nonmarket economies. The Department of Commerce can change this rule and make countervailing duties applicable to nonmarket economies without affecting China’s nonmarket status in antidumping cases.⁴² If Commerce declines to do so, Congress should legislate the applicability of countervailing duties to China. Countervailing duties are an important tool for the protection of domestic industry from subsidized imports.

The U.S. government has still other important trade law remedies for combating unfair Chinese trade practices. For instance, the AFL-CIO filed a petition in March 2004 asking USTR to initiate a section 301 investigation of China’s labor practices.⁴³ The petition could have triggered a USTR investigation to determine if

China's labor practices are "unjustifiable and burden or restrict United States commerce." Section 301 of the 1974 Trade Act grants USTR the capacity under U.S. trade law to impose punitive measures in an effort to correct unfair trading practices of U.S. trade partners.⁴⁴ In April 2004, USTR refused to investigate China's labor practices, claiming that the United States would achieve better results with the administration's strategy of utilizing negotiations and more selective use of enforcement mechanisms.⁴⁵

RECOMMENDATIONS

The Commission made additional recommendations on this topic in its transmittal letters to Congress forwarding the record of the Commission's hearings of September 25, 2003, and February 5, 2004, which are attached at appendix II.

- The Commission recommends that Congress press the administration to make more use of the WTO dispute settlement mechanism and/or U.S. trade laws to redress unfair Chinese trade practices. In particular, the administration should act promptly to address China's exchange rate manipulation, denial of trading and distribution rights, lack of IPR protection, objectionable labor standards, and subsidies to export industries. In pursuing these cases, Congress should encourage USTR to consult with trading partners who have mutual interests at the outset of each new trade dispute with China.
- The Commission recommends that Congress press the administration to make better use of the China-specific section 421 and textile safeguards negotiated as part of China's WTO accession agreement to give relief to U.S. industries especially hard hit by surges in imports from China.
- Notwithstanding China's commitments at the April 2004 JCCT meeting, the Commission recommends that Congress press the administration to file a WTO dispute on the matter of China's failure to protect intellectual property rights. China's WTO obligation to protect intellectual property rights demands not only that China promulgate appropriate legislation and regulations, including enacting credible criminal penalties, but also that these rules be enforced. China has repeatedly promised, over many years, to take significant action. Follow-through and action have been limited and, therefore, the Commission believes that immediate U.S. action is warranted.
- The Commission recommends that Congress urge the Department of Commerce to make countervailing duty laws applicable to nonmarket economies. If Commerce does not do so, Congress should pass legislation to achieve the same effect. U.S. policy currently prevents application of countervailing duty laws to non-market economy countries such as China. This limits the ability of the United States to combat China's extensive use of subsidies that give Chinese companies an unfair competitive advantage.
- The Commission recommends that Congress encourage the administration to make a priority of obtaining and ensuring China's compliance with its WTO commitments to refrain from forced technology transfers that are used as a condition of doing

business. The transfer of technology by U.S. investors in China as a direct or indirect government-imposed condition of doing business with Chinese partners remains an enduring U.S. security concern as well as a violation of China's WTO agreement. A WTO complaint should be filed when instances occur.

- The Commission recommends that Congress encourage USTR and other appropriate U.S. government officials to take action to ensure that the WTO's Transitional Review Mechanism process is a meaningful multilateral review that measures China's compliance with its WTO commitments. If China continues to frustrate the TRM process, the U.S. government should initiate a parallel process that includes a specific and comprehensive measurement system. The United States should work with the European Union, Japan, and other major trading partners to produce a separate, unified annual report that measures and reports on China's progress toward compliance and coordinates a plan of action to address shortcomings. This report should be provided to Congress. In addition, independent assessments of China's WTO compliance conducted by the U.S. government, such as USTR's annual report, should be used as inputs in the multilateral forum evaluating China's compliance, whether that forum is a reinvo-gated and effective TRM or a new process.
- The Commission recommends that Congress consider options to assist small-and medium-sized business in pursuing trade remedies under U.S. law, such as through section 421 cases.

ENDNOTES

1. U.S.-China Economic and Security Review Commission, *Hearing on China and the WTO: Compliance and Monitoring*, testimony of Eric H. Smith, February 5, 2004, p. 136.

2. Neil King Jr., "China Agrees to Curb Piracy of U.S. Goods," *Wall Street Journal*, April 22, 2004, A-2.

3. U.S.-China Economic and Security Review Commission, *Hearing on China and the WTO: Compliance and Monitoring*, testimony of Charles Freeman, February 5, 2004, p. 27.

4. U. S. General Accounting Office, *World Trade Organization: First-Year U.S. Efforts to Monitor China's Compliance*, GAO-03, 461 (Washington, DC: March 31, 2003).

5. China's average tariff rate is currently 10.4 percent and will be reduced to 9.8 percent by 2010 if China's WTO accession agreements on the matter are implemented. "China Cutting Average Tariff Rate to 10.4%," *China Daily*, January 2, 2004.

6. China committed to granting trading and distribution rights to foreign minority-owned joint ventures by December 11, 2002. For this and the following bullet, the December 11, 2003, deadline applies to foreign majority-owned joint ventures.

7. United States Trade Representative, *2003 Report to Congress on China's WTO Compliance* (Washington, DC: December 11, 2003); see also GAO, *World Trade Organization: Analysis of China's Commitments to Other Members*, GAO-02-1056 (Washington, DC: October 3, 2002); and Julie Walton, "WTO: China Enters Year Three," *China Business Review*, vol. 31, no. 1 (Jan.-Feb. 2004). For a more comprehensive analysis of China's obligations, see Stewart, *Accession of The People's Republic of China to the World Trade Organization*.

8. GAO, *World Trade Organization: First-Year U.S. Efforts to Monitor China's Compliance*.

9. See the record of the Commission's hearing on *China and the WTO: Compliance and Monitoring*, held on February 5, 2004. See also USTR's *2003 Report to Congress on China's WTO Compliance*, the report by Terence P. Stewart, and the numerous reports of industry groups.

10. National Association of Manufacturers (NAM), *Review of China's Compliance with its WTO Commitments*, (Washington, DC: NAM, September 10, 2003); and

Wayne M. Morrison, *China and the World Trade Organization*, Congressional Research Service Report to Congress (Washington, DC: August 6, 2003).

11. International Intellectual Property Alliance's *2003 Special 301 Report: People's Republic of China* (Washington, DC: February 13, 2004). Available at www.iipa.com/rbc/2004/2004SPEC301CHINA.pdf.

12. U.S.-China Business Council, *China's WTO Implementation: a Mid-Year Assessment* (Washington, DC: 2003); and Robert Vastine, *Progress of China's Compliance with WTO Commitments to Liberalization of Trade in Services*, Coalition of Service Industries, Statement to the Trade Policy Staff Committee (Washington, DC: October 3, 2003).

13. National Electrical Manufacturers Association, *Statement by the National Electrical Manufacturers Association (NEMA) for TPSC (Trade Policy Staff Committee) Review of China's Compliance with its World Trade Organization (WTO) Obligations* (Washington, DC: September 18, 2003); U.S.-China Economic and Security Review Commission, *Hearing on China and the WTO: Compliance and Monitoring*, testimony of Robert Carlson, February 5, 2004, p. 109; and United States Council for International Business, *China WTO Written Comments: Trade Policy Staff Committee* (Washington, DC: September 10, 2003).

14. Information Technology Industry Council Press Release, "Top Administration Officials Challenge Chinese WLAN Standard" (March 4, 2004). Available at www.itic.org/2003prs/040304.2.htm.

15. Semiconductor Industry Association, "SIA Issue Backgrounders: China." Available at www.semichips.org/backgrounders—china.cfm

16. William B. Abnett and Robert B. Cassidy, *China's WTO Accession: The Road to Implementation*, National Bureau of Asian Research Special Report, No. 3 (Seattle, WA: November 2002).

17. U.S. Chamber of Commerce, *China's WTO Record: A Two-Year Assessment* (Washington, DC: September 18, 2003).

18. U.S.-China Economic and Security Review Commission, *Hearing on China's Industrial, Investment and Exchange Rate Policies: Impact on the U.S.*, Testimony of Kathleen Walsh, September 25, 2003, p. 161.

19. U.S.-China Economic and Security Review Commission, *Hearing on China as an Emerging Regional and Technological Power: Implications for U.S. Economic and Security Interests*, testimony of Peter Cowhey, February 13, 2004, p. 17.

20. Walton, "WTO: China Enters Year Three."

21. American Chamber of Commerce in China, *2003 White Paper on American Business in China*.

22. Myron Brilliant, *China's WTO Record: A Two-Year Assessment* (statement prepared October 3, 2003, for the Interagency Trade Policy Staff Committee).

23. The National Association of Manufacturers, *Review of China's Compliance with its WTO Accession Commitments* (comments submitted to the interagency Trade Policy Staff Committee, September 10, 2003).

24. U.S.-China Economic and Security Review Commission, *Hearing on China and the WTO: Compliance and Monitoring*, testimony of Robert Cassidy, February 5, 2004, pp. 63–4.

25. U.S. International Trade Commission, *Understanding Safeguard Investigations*. Available at www.usitc.gov/us201.htm.

26. Peter S. Goodman, "China Assails Import Limits," *Washington Post*, November 20, 2003.

27. U.S.-China Economic and Security Review Commission, *Hearing on China's Impact on the U.S. Manufacturing Base*, testimony of Norman Chapman, January 30, 2004, p. 32.

28. Findings available from the ITC, "Investigations Under Section 421 of the Trade Act of 1974." Available at www.usitc.gov/7ops/chinasafeguard.htm.

29. The statute governing section 421 cases instructs the president to take into account, *inter alia*, "(D) the probable effectiveness of the actions authorized under paragraph (3) [options for import relief] to facilitate positive adjustment to import competition; (E) the short- and long-term economic and social costs of the actions authorized under paragraph (3) relative to their short- and long-term economic and social benefits and other considerations relative to the position of the domestic industry in the United States economy; (F) other factors related to the national economic interest of the United States, including, but not limited to: (i) the economic and social costs which would be incurred by taxpayers, communities, and workers if import relief were not provided under this part, (ii) the effect of the implementation of actions under this section on consumers and on competition in domestic markets for articles, and (iii) the impact on United States industries and firms as a result of international obligations regarding compensation." U.S. Code, title 19, chapter 12, section 2253.

30. U.S.-China Economic and Security Review Commission, *Hearing on China and the WTO: Compliance and Monitoring*, testimony of Robert Cassidy, February 5, 2004, p. 65.

31. U.S.-China Economic and Security Review Commission, *Hearing on China and the WTO: Compliance and Monitoring*, testimony of Terence P. Stewart, February 5, 2004, p. 68.

32. House Appropriations Subcommittee for the Departments of Commerce, Justice, State, the Judiciary, and Related Agencies, Hearing on *The Effects of Chinese Imports on U.S. Companies*, testimony of William Wolf, May 22, 2003.

33. House Appropriations Subcommittee for the Departments of Commerce, Justice, State, the Judiciary, and Related Agencies, Hearing on *The Effects of Chinese Imports on U.S. Companies*, testimony of Deputy USTR Peter Allgeier, May 22, 2003.

34. In order to reject the suggestion of the ITC to provide import relief, the president must supply a detailed explanation to Congress. Presidential explanations for each case can be found in the report by Terence P. Stewart, page 230. In each of the three cases, the president's explanation considered relief to be either ineffective or outweighed by negative impacts on U.S. producers and consumers.

35. U.S.-China Economic and Security Review Commission, *Hearing on China and the WTO: Compliance and Monitoring*, testimony of James Jochum, February 5, 2004, p. 11.

36. Stewart, *China's Compliance with World Trade Organization Obligations*.

37. USTR press release, "USTR Zoellick to Visit China February 17-20 to Discuss WTO Impact, China's Implementation, and Bilateral Trade Issues" (Washington, DC: February 14, 2003). Available at <http://www.ustr.gov/releases/2003/02/03-09.pdf>.

38. USTR press release, "USTR Announces New China Office, Other Organizational Changes" (Washington, DC: April 13, 2004). Available at www.ustr.gov/releases/2004/04/04-31.pdf.

39. Department of the Treasury press release, "Secretary Snow Appoints Ambassador Paul Speltz as Economic and Financial Emissary to China" (Washington, DC: April 14, 2004). Available at www.ustreas.gov/press/releases/js1325.htm.

40. U.S.-China Economic and Security Review Commission, *Hearing on China and the WTO: Compliance and Monitoring*, testimony of Anne Craib, February 5, 2004, p. 141.

41. The Commission heard this opinion expressed frequently during its discussions with WTO officials and member country representatives in Geneva. For example, the European Union and Japan only joined the semiconductor case after the United States took decisive action.

42. Stewart and Stewart Law Offices, *Application of U.S. Countervailing Duty Laws to NMEs [Nonmarket Economies] (Particularly China): Time for Change* (Washington, DC: April 8, 2004).

43. AFL-CIO press release, "AFL-CIO Challenges Bush on China Trade Abuses" (Washington, DC: March 16, 2004). Available at www.afl-cio.org/mediacenter/prspmt/pr03162004.cfm.

44. Section 301 investigations can also judge whether another country's practice "violates, or is inconsistent with, the provisions of, or otherwise denies benefits to the United States under, any trade agreement." This provision is contained in section 301(a)(1)(A)(i). A January 2000 WTO ruling established that any investigations by the USTR into alleged violations of WTO agreements would have to be pursued within the WTO's dispute resolution framework. The ruling neither considered nor circumscribed the ability of the USTR to examine and act on a trading practice that "is unjustifiable and burdens or restricts U.S. commerce," as covered in section 301(a)(1)(A)(ii). Ultimately, however, any punitive measure imposed by the United States that falls within the issue areas addressed by the WTO would be open to a WTO dispute. The language regarding section 301 cases can be found in the U.S. Code, title 19, chapter 12, section 2411. Jean Heilman Grier of the Office of Chief Counsel for International Commerce (Department of Commerce) prepared an explanation, "section 301 of the 1974 Trade Act," in October 2001 that explains the processes and limits of section 301 investigations. It is available at www.osec.doc.gov/ogc/occic/301.html.

45. USTR press release, "Statement of U.S. Trade Representative Robert B. Zoellick on U.S.-China Trade Relations" (Washington, DC: April 28, 2004).