

SECTION 3: EVALUATING CHINA'S PAST AND FUTURE ROLE IN THE WORLD TRADE ORGANIZATION

Introduction

China joined the World Trade Organization (WTO) on December 11, 2001, with the strong support of both the U.S. administration and Congress, and many U.S.-based multinational corporations. Not only would the U.S. economy benefit from increased exports to China, they claimed, but China's accession to the WTO also would enhance U.S. national security, transform China's Communist Party and its authoritarian government, and open China to new ideas from the West, including democracy and human rights. The final stages of China's 13-year negotiation to join the WTO were conducted from 1988 through 2000 during the administrations of George H.W. Bush and Bill Clinton, both of whom strongly supported China's membership. During Congress's debate in 2000 on whether to grant China Permanent Normal Trade Relations (PNTR), a precursor to China's WTO accession, President Clinton extolled the importance to the United States of China's WTO membership: "Even though for me the economic choice is clear ... far, far more important to me are the moral and national security arguments."¹²⁵ Said Clinton:

Yes, it's a good economic deal. China has agreed to open its markets. ... All we give them is membership, and they do all the market opening. ... [B]y forcing China to slash subsidies and tariffs that protect inefficient industries, which the Communist Party has long used to exercise day-to-day control, by letting our high-tech companies in to bring the Internet and the information revolution to China, we will be unleashing forces that no totalitarian operation rooted in the last century's industrial society can control.

Large, U.S.-headquartered multinational businesses saw China as a major market and a major source of supply for all other markets, including the United States. They also anticipated that a China bound by the rules of the WTO would be a more stable place for investment.¹²⁶ On May 25, 2000, the day after the House of Representatives voted to give China PNTR, the *Wall Street Journal* noted that:

[W]hile the debate in Washington focused mainly on the probable lift for U.S. exports to China, many U.S. multinationals have something different in mind. 'This deal is about investment, not exports,' says Joseph Quinlan, an economist with Morgan Stanley Dean Witter & Co. 'U.S. foreign investment is about to overtake U.S. exports as the

*primary means by which U.S. companies deliver goods to China.*¹²⁷

The United States also had geopolitical goals—to work with China on major foreign policy objectives, including those involving North Korea, Iran, and possibly Taiwan, as well as to have a relatively stable and potentially positive relationship with a major emerging power.¹²⁸ President Clinton’s National Security Council advisor, Samuel Berger, raised the national security argument for supporting China’s WTO accession, saying:

*[T]his debate should not be defined as economic rights versus human rights—or economic security versus national security. That is a trap, a false choice. This agreement is just as vital ‘if not more vital’ to our national security as it is to our economic security. It is far more likely to move China in the right direction—not the wrong direction—on all of our other concerns. We can’t duck these issues by saying we’re only interested in talking about economics. If we are going to win this debate, we must be persuasive that it promotes both growth and jobs in America and progress toward change in China.*¹²⁹

As predicted, U.S.-China trade has grown rapidly since China’s accession. But another predicted result, a more balanced trading relationship between the two countries, has not occurred. In 1999, for example, Kenneth Lieberthal, then a special advisor to President Clinton and senior director for Asia affairs at the National Security Council, said:

*[The U.S. trade deficit with China] will not grow as much as it would have grown without this agreement [to allow China’s entry into the WTO] and over time clearly it will shrink with this agreement.*¹³⁰

In fact, just the opposite occurred. The U.S. trade deficit with China increased steadily through 2008 (the deficit shrank in 2009 as a consequence of the global economic crisis but resumed its growth in 2010). Since China’s entry into the WTO in 2001, the United States has run a cumulative deficit in goods with China of over \$1.76 trillion.¹³¹ Moreover, China’s share of the U.S. global deficit continued to grow, as table 1 demonstrates.

Table 1: U.S. Current Account Balance with China and the World (U.S. \$ billions)

Year	U.S. balance with world	U.S. balance with China	China’s share of U.S. global trade deficit
2000	–\$417	–\$88	21%
2001	–\$398	–\$89	22%
2002	–\$459	–\$110	24%
2003	–\$522	–\$132	25%
2004	–\$631	–\$172	27%
2005	–\$748	–\$219	29%
2006	–\$803	–\$261	33%

**Table 1: U.S. Current Account Balance with China and the World
(U.S. \$ billions)—Continued**

Year	U.S. balance with world	U.S. balance with China	China's share of U.S. global trade deficit
2007	-\$718	-\$295	41%
2008	-\$669	-\$308	46%
2009	-\$378	-\$264	70%

Source: Bureau of Economic Analysis, *U.S. International Transactions Accounts Data* (Washington, DC: Department of Commerce, September 14, 2010).

The Chinese leadership viewed WTO membership as a top national priority, underpinned by the belief that China's future economic prosperity and status as a global power depended on greater integration with world markets.¹³² On December 11, 2001, the day China formally entered the WTO, *People's Daily*, the Chinese Communist Party's official news outlet, noted China's goals in joining the WTO, including the pursuit of further economic reforms; the attraction of foreign investment, capital, and technology; and the expansion of export markets:

*We should continue to deepen reform of the foreign trade system, make major efforts to foster new growth points of export and promote the diversification of the mainstays of foreign trade management. ... We should closely integrate the absorption of foreign capital with the upgrading of domestic industries, the coordination of development of regional economies, the reorganization and transformation of State-owned enterprises and the expansion of exports. ... We should actively spur foreign capital to flow into high and new technological industries, and encourage transnational corporations to come to China to set up R&D [research and development] centers and regional headquarters.*¹³³

The last goal, in particular, has proved problematic for U.S. interests, as China started implementing additional policies that attract foreign high-tech businesses by using extensive subsidies, and then demanding technology transfer, while at the same time threatening to withdraw market access if they do not wish to hand over technological know-how.¹³⁴ The U.S. Trade Representative's (USTR) *2009 Report to Congress on China's WTO Compliance* notes a "growing concern" among U.S. businesses and industries that "the pace of economic reform in China appears to have slowed in key sectors, and there are growing indications that China's movement toward a market economy has stalled."¹³⁵ Though most American and other foreign businesses express optimism about China's potential for growth, AmCham-China's *2010 Business Climate Survey* reflects the growing concern among the American business community that China's regulations are increasingly discriminating against American companies.¹³⁶ AmCham-China also worries that many new industrial policies are protectionist in nature and that progress toward greater reliance on market-oriented mechanisms has slowed, allowing a return to reliance on administrative measures to manage the economy.¹³⁷

China's WTO Compliance: Priority Issues

While China has taken steps toward meeting its WTO commitments,¹³⁸ further liberalization has been thwarted in some cases by other Chinese policies, “including a number of industrial policies . . . that favor state-owned, state-related and other domestic entities over foreign firms.”¹³⁹

As described by Deputy United States Trade Representative Michael Punke during the WTO's third Trade Policy Review of China in May 2010:

In the first years after China's accession to the WTO, China made noteworthy progress in adopting economic reforms that facilitated its transition toward a market economy and increased the openness of its economy to trade and investment. However, beginning in 2006, progress toward further market liberalization began to slow.

By the time of China's [WTO] Trade Policy Review in 2008, the United States noted evidence of a possible trend toward a more restrictive trade regime, citing several Chinese measures signaling new restrictions on market access and foreign investment in China. At the root of many of these problems was China's continued pursuit of problematic industrial policies that relied on excessive government intervention in the market through an array of trade-distorting measures designed to promote and protect domestic industries. This government intervention appeared to be a reflection of China's historic yet unfinished transition from a centrally planned economy to a free-market economy governed by rule of law.

Since China's [WTO] Trade Policy Review in 2008, there is increasing evidence of such a restrictive trend. Examples from the past two years include: (1) the continued and incrementally more restrictive use of export quotas and export duties on a large number of raw material inputs; (2) the selective use of other border measures such as value-added tax rebates to encourage or discourage exports of particular products; (3) the setting and enforcement of unique Chinese national standards, such as an informal requirement that all new 3G mobile handsets be enabled with a unique Chinese national standard for wireless Internet access; (4) China's government procurement practices, including an array of new central, provincial and local government 'Buy China' policies; (5) a new Postal Law that excludes foreign suppliers from a major segment of the domestic express delivery market; (6) impediments to the foreign supply of value-added telecommunications services and an informal ban on new entrants in China's basic telecommunications sector; and (7) continuing significant restrictions on foreign investment in China, along with continuing consideration of 'national economic security' when evaluating foreign investment through mergers and acquisitions.¹⁴⁰

Detailed below are snapshots of China's WTO noncompliance and promotion of discriminatory industrial policies that were highlighted by witnesses at the Commission's June 9 hearing on China's role in the WTO.

Indigenous Innovation

China continues to employ industrial policies that, in the words of Deputy U.S. Trade Representative Demetrios Marantis, "limit market access [for foreign businesses] or otherwise skew [the U.S.-China] trading relationship."¹⁴¹ One such measure, the "indigenous innovation" government procurement policy, recently has provoked international opposition. In his testimony before the Commission, Terence P. Stewart, an international trade lawyer, called China's indigenous innovation policies "a clear example of China's attempts to promote industrial policies that favor Chinese industries while at the same time limiting market access for foreign-origin goods and service providers."¹⁴² Being excluded from China's government procurement is a big disadvantage for foreign companies: The Chinese government estimated that in 2009, the Chinese government procurement market surpassed \$100 billion, but this is a significant understatement of its true size (for example, the Chinese Ministry of Finance's limited definition of government procurement spending does not include most government infrastructure projects, and procurement by state-owned enterprises is not included, even when they perform government functions).¹⁴³

China and the WTO Agreement on Government Procurement

The controversy over China's "indigenous innovation" policies focused international attention on China's unfulfilled 2001 promises to join the WTO Agreement on Government Procurement. China made a commitment at the last WTO Government Procurement Agreement Committee meeting and at the May 24–25, 2010, Strategic and Economic Dialogue (S&ED) to submit a revised offer for acceding to the plurilateral Government Procurement Agreement. The previous Chinese Government Procurement Agreement accession offer, made in late 2007, was strongly criticized by trading partners, as it did not commit subcentral government agencies, exempted state-owned enterprises, contained high thresholds, and included a 15-year grace period during which China would not have to implement any Government Procurement Agreement obligations.¹⁴⁴

In mid-July 2010, China's long-awaited revised offer for acceding to the Government Procurement Agreement was delivered to the WTO. China claimed that the revised submission was a significant improvement over Beijing's initial offer, but there were still significant shortcomings.¹⁴⁵ For example, the new offer would not cover provincial or local government agencies or state-owned enterprises, which comprise a significant share of the Chinese government's procurement.¹⁴⁶ The dominance of the state-owned enterprises in the Chinese economy is one of the reasons

**China and the WTO Agreement on
Government Procurement—Continued**

the United States has not designated China as a market economy—a goal China has been pursuing for many years. The United States has a statutory test for determining whether an economy can be classified as a market economy.* The factors to be considered under U.S. law in granting market economy status include the extent to which the country's currency is convertible, the extent to which wage rates are freely determined by negotiations between labor and management, and the extent to which the government owns or controls the means and decisions of production.¹⁴⁷ However, under its WTO accession agreement, China will automatically attain market economy status by 2016, and the United States will lose the ability to treat China as a non-market economy when determining antidumping penalties, which can frequently result in higher fees.

In the new offer, the proposed final threshold for central government purchasing of construction services is still three times higher than most other Government Procurement Agreement members.¹⁴⁸ The offer also reserves the right for the Chinese government to “require the incorporation of domestic contents, offset procurement, or transfer of technology.”¹⁴⁹ The revised offer was not accepted by China's trading partners.¹⁵⁰

Membership in the WTO Agreement on Government Procurement is voluntary; a country can be a WTO member without ever acceding to the agreement. Until China signs the Government Procurement Agreement, it is not a WTO violation for China to discriminate in its government procurement nor for other WTO members to discriminate against Chinese goods and services in their government purchases.

In December 2007, China issued two measures aimed at limiting the government's procurement of foreign goods and services. The first, *Administrative Measures for Government Procurement and Ordering of Indigenous Innovative Products*, restricts government procurement of “indigenous innovative” products to “Chinese” products manufactured within China. The second, *Administrative Measures for Government Procurement of Imported Products*, severely restricts government procurement of imported foreign products and technologies.¹⁵¹ The central government and provincial governments have since followed up by creating catalogues of qualifying “indigenous innovation products.”

Subsequently, in November 2009, China issued the *Circular on Launching the 2009 National Indigenous Innovation Product Accreditation Work*, requiring companies to file applications by December 2009 for their products to be considered for accreditation as

* In the most basic sense, a market economy is an economic system in which decisions about the allocation of resources and production are made on the basis of prices generated by voluntary exchanges among producers, consumers, workers, and owners of factors of production. This is contrasted with a planned economy, in which crucial economic processes are determined to a large extent not by market forces but by an economic planning body that implements major economic goals.

“indigenous innovation products.”¹⁵² This circular indentified eligible products and the criteria for being accredited as a national indigenous innovation product. These include computer and application devices, communication products, modernized office equipment, software, “new energy and equipment,” and energy-efficient products.¹⁵³

Several provisions of the circular were problematic: For example, the circular provided that to qualify as an indigenous innovation product, the product’s intellectual property “must originally be registered in China.”¹⁵⁴ The same “first registration in China” requirement also applied to the product’s trademarks and brands. In addition, the circular required that a product must have highly advanced technology that equals or exceeds international standards.¹⁵⁵

Responding to the WTO’s *2010 Trade Policy Review of China*, the United States has criticized this measure as discriminatory, limiting market access for foreign companies and interfering with the exercise of intellectual property rights:

*At present, the industrial policies generating the most controversy are China’s so-called ‘indigenous innovation’ policies. Over time, it has become evident that many of these programs contain elements that could discriminate against foreign products, foreign investors, foreign technology and/or foreign intellectual property. Recent measures have generated intense concern among WTO Members and their business communities by more concretely demonstrating a policy direction that seems designed to limit market access for imports and foreign investors and pressure enterprises to localize research and development in China, as well as transfer technologies.*¹⁵⁶

Indeed, in a letter to senior Obama Administration officials, the heads of 19 U.S. business and industry associations warned that the new procurement rules issued by the Chinese government represent “an unprecedented use of domestic intellectual property as a market-access condition [that] makes it nearly impossible for the products of American companies to qualify unless they are prepared to establish Chinese brands and transfer their research and development of new products to China.”¹⁵⁷

China’s record of poor intellectual property rights protection, which has led to theft of foreign technologies and piracy of creative content, gained a new dimension in light of indigenous innovation policies. One of the primary goals of the indigenous innovation policy is to reduce China’s dependence on foreign technologies while at the same time fostering domestic companies to emerge as an innovative power in their own right.¹⁵⁸ Foreign government and technology enterprises worry that Beijing will “intervene in the market for [intellectual property] and help its own companies ‘re-innovate’ competing [intellectual property] as a substitute for foreign technologies, and potentially misappropriate U.S. and other foreign [intellectual property].”¹⁵⁹ A report by the U.S. Chamber of Commerce noted that many international technology companies called the indigenous innovation guidelines “a blueprint for technology theft on a scale the world has never seen before.”¹⁶⁰

China's indigenous innovation policies, including the use of government procurement preferences to promote innovative domestic goods, were strongly protested by the U.S., European, and other international business groups in the lead-up to the May 24–25, 2010, Strategic and Economic Dialogue. The United States pointed out that China had made commitments to “require that products produced in China by foreign invested enterprises are treated as domestic products and will issue rules in this regard.”¹⁶¹ That promise had first been made at the October 28–29, 2009, meeting of the Joint Commission on Commerce and Trade.

In April 2010, China revised its accreditation circular to address some of the concerns raised by the United States and others. In the revised circular, China relaxed the intellectual property, trademark, and brand “first registration in China” requirement and changed the highly advanced technology requirement to one calling for a product to be proven effective in conserving energy, reducing pollution, and/or raising energy efficiency, or “substantially” improving on an original product's structure, quality, material, craftsmanship, or performance.¹⁶² These changes, however, have not alleviated U.S. and European objections to this measure.

Consequently, the Obama Administration elevated the criticism of Chinese indigenous innovation standards to one of the two top issues on the economic track of the S&ED, alongside currency exchange rate issues.¹⁶³ According to the joint fact sheet issued at the conclusion of the May 24–25 S&ED, the United States and China agreed to “conduct intensive, expert and high-level discussions commencing as soon as possible this summer about innovation issues, under the auspices of the Sino-U.S. Joint Commission Meeting on Scientific and Technological Cooperation.”¹⁶⁴ However, following the May 24–25 S&ED, Under Secretary of Commerce for International Trade Francisco Sánchez said that “China did not agree to a U.S. request to suspend its indigenous innovation policy” made at the S&ED, although China “did agree to provide additional time for U.S. industry and government comments on how it could achieve its goal of promoting innovation in China without discriminating against foreign companies.”¹⁶⁵

Export Restrictions

In June 2009, the United States filed a WTO case against China to address a variety of export restrictions that China imposes on nine raw materials. While no decision has been issued in this case, the WTO's *2010 Trade Policy Review* of China criticized China's use of export restraints in general and refuted China's stated rationales for using them:

[W]hether intended or not, export restraints for whatever reason tend to reduce export volumes of the targeted products and divert supplies to the domestic market, leading to a downward pressure on the domestic prices of these products. The resulting gap between domestic prices and world prices constitutes implicit assistance to domestic downstream processors of the targeted products and thus pro-

vides them a competitive advantage. Insofar as China is a major supplier of such a product, export restraints may also shift the terms of trade in China's favor. Also, some export restrictions might be imposed to pre-empt imposition of import restrictions by governments in export markets.

More generally, export restraints may not be the best way to achieve some of the objectives/rationales mentioned above. In particular, restricting the export of some highly polluting or high-energy consuming products is not the most economically efficient way to protect the environment or reduce energy consumption. Nor are export restraints the best way to conserve natural resources.¹⁶⁶

China, however, has also tightened its control over the supply of rare earth elements, valuable minerals that are used prominently in the production of diverse high-technology goods, from flat panel screens to hybrid car batteries and special magnets used in wind turbines.* Rare earth minerals are also critical for many military technologies, including the magnets used in the guidance systems of U.S. military smart bombs like Joint Direct Attack Munitions, and superalloys (used to make parts for jet aircraft engines).

China accounts for over 95 percent of the world's production of rare earth minerals, and for the last three years it has been reducing the amount that can be exported.¹⁶⁷ After the Ministry of Industry and Information Technology issued in August 2009 a draft policy outlining the tightening of exports for rare earth minerals, Zhao Shuanglian, deputy chief of the Inner Mongolia autonomous region, spoke out to quell global concerns. According to Mr. Zhao, rare earth elements are "the most important resource for Inner Mongolia," which contains 75 percent of China's deposits, and by cutting exports and controlling production, the government wants to "attract users of rare earths to set up in Inner Mongolia" to develop manufacturing.¹⁶⁸ China also is taking steps to consolidate its rare earths industry, with the aim of creating a consortium of state-owned miners and processors in Inner Mongolia.¹⁶⁹

Despite the international outcry that followed the initial announcement of export restraints, China further cut the export quotas for rare earth minerals by 72 percent for the second half of 2010, with shipments capped at 7,976 metric tons, down from 28,417 tons for the same period last year.¹⁷⁰ Earlier this year, China put limits on rare earth production and stopped issuing new exploration licenses until June 30, 2011. It also launched a crack-down on illegal rare earth mining in June 2010 to stamp out unauthorized supplies.¹⁷¹ The central government is also planning to create a unified price for rare earth metals in five provinces, which will include establishing a unified transportation and sales system and consolidating production into three to five state-owned conglomerates in the long term.¹⁷²

*The rare earth elements group is comprised of 17 minerals—scandium, yttrium, and the 15 lanthanoids—and they play a crucial role in many advanced technological devices. For more information, see, for example, Gordon B. Haxel, James B. Hedrick, and Greta J. Orris, "Rare Earth Elements—Critical Resources for High Technology," U.S. Geological Survey Fact Sheet 087-02 (Reston, VA: 2002). <http://pubs.usgs.gov/fs/2002/fs087-02/fs087-02.pdf>.

“In the long run, steps will be taken to heighten the influence of domestic miners on the price of the minerals in the global market,” *China Daily* quoted an unnamed source as saying.¹⁷³ This scenario seems increasingly likely, as a leading producer of rare earth minerals has also been given permission to set up a strategic reserve in the northern region of Inner Mongolia.¹⁷⁴

China’s Ministry of Industry and Information Technology said it is limiting production in some mines and closing others completely, because some of the rare earths are extracted under dire environmental conditions, while others are mined illegally. Tighter limits on exports of rare earths place foreign manufacturers at a disadvantage, however, compared to the domestic producers, whose access will not be so restricted.¹⁷⁵

China’s Support of its Green Tech Sector

China’s export restrictions on rare earth elements and other minerals, which are used extensively in green technologies, significantly benefit Chinese manufacturers of alternative and renewable energy equipment. The Chinese green tech industry also benefits from numerous other central and local government policies—from heavily subsidized land and low interest loans to local content requirements, currency undervaluation, and government procurement rules favoring domestic companies. These government favors helped make China the global leader in manufacturing and exporting clean energy products, leaving foreign companies struggling to compete.

The kind of help China gives its green tech manufacturers, however, may violate WTO rules banning subsidies to exporters.¹⁷⁶ In September 2010, the United Steelworkers union filed a trade case under Section 301 of U.S. trade law alleging that dozens of practices utilized by the Chinese government to develop their green tech sector were established at the expense of U.S. competitors.¹⁷⁷ On October 15, 2010, U.S. Trade Representative Ron Kirk announced that the United States has initiated an investigation in response to the United Steelworkers’ petition.¹⁷⁸ The investigation may ultimately lead to a formal dispute settlement case under WTO auspices. (For an in-depth look at China’s subsidization of its green tech sector and further details on the Section 301 petition, see chap. 4, sec. 2, of this Report.)

Despite China’s protestations that rare earth minerals restrictions are not being used for political reasons, recent developments in exports of rare earths to Japan raise concerns for the global economy. Amid a dispute over Japan’s detention of the captain of a Chinese fishing boat that collided with Japanese coast guard boats in contested waters of the East China Sea in September 2010, reports emerged that shipments of rare earths from China to Japan were being intentionally held up at Chinese ports.¹⁷⁹ Although the Chinese Ministry of Commerce denied ordering an em-

bargo, among Japanese importers rumors continued to circulate about an informal ban.¹⁸⁰ Shippers in several Chinese cities have also reported that Chinese customs officials have increased spot inspections of goods bound for Japan and being imported from the country, which can add costly delays to shipments.¹⁸¹ It is unclear whether the broad slowdown by Chinese customs was responsible for the cessation of rare earths shipments or for how long the tightened inspection procedures will remain in place.

Financial Services and Electronic Payment Processing

Trade in services is a key component of the American economy. Services represent over 75 percent of the U.S. gross domestic product (GDP), and the United States continues to have a significant overall trade surplus in the services trade (\$132 billion in 2009).¹⁸² Prior to China's WTO accession, U.S. financial institutions hoped to conduct foreign and domestic currency business in China. Since its accession to the WTO, China has complied with some, but not all, of its commitments.¹⁸³

For example, Calman J. Cohen, president of the Emergency Committee for American Trade, testified at the Commission's hearing in June 2010 that China still restricts the activities of Chinese-foreign joint venture banks. China also limits the ability of foreign banks to operate electronic payment systems for single-brand, renminbi (RMB)-denominated credit and debit cards.¹⁸⁴ U.S. companies complained that China is violating trade rules by shutting them out of its \$723 billion payments-processing market.¹⁸⁵

Under current Chinese rules, wholly owned foreign financial companies cannot supply credit card and electronic payment services through their own networks to Chinese customers priced in local currency. Instead, foreign banks must form a joint venture with Chinese operators, "co-brand" their cards, and conduct payments through the Chinese monopoly payment network China UnionPay, which routs information from credit cards to banks for approval.¹⁸⁶

China made a commitment in its WTO Services Schedule to allow foreign financial institutions to provide "all payment and money-transmission services, including credit, charge and debit cards" independently from Chinese banks and in foreign and local currency by December 11, 2006. The United States has raised this issue with China repeatedly, but there has been no change.¹⁸⁷

Although the restrictions at issue affect all major U.S. credit and debit card companies, including Visa, MasterCard, and American Express, on September 14, 2010, MasterCard announced it had signed a memorandum of understanding with UnionPay aimed "at mutually beneficial business development."¹⁸⁸ MasterCard said the cooperation may lead to future deals that improve merchant acceptance for MasterCard customers traveling to China and for UnionPay cardholders who travel abroad, but no further details have been made public.¹⁸⁹ Meanwhile, Visa, MasterCard's larger rival, said it has been blocked from starting any new business in China for almost one year after a disagreement with China UnionPay.¹⁹⁰

On September 15, 2010, U.S. Trade Representative Ron Kirk announced that the United States has requested dispute settlement consultations—the first step to litigation—concerning China's discrimination against U.S. suppliers of electronic payment serv-

ices.¹⁹¹ In a separate request for consultations filed on the same day, the United States challenged China's imposition of antidumping and countervailing duties on imports of U.S. grain oriented flat-rolled electrical steel.¹⁹²

WTO Effectiveness in Addressing Many of China's Industrial Policies

As of this Report's publication, the United States has filed ten dispute settlement cases against China, and China has filed five cases against the United States (see tables 2 and 3). Of the ten cases in which China was the defendant, three are pending. Many witnesses testifying before the Commission's June 2010 hearing believed that despite many WTO cases brought by the United States to address China's trade-distorting practices, the WTO is ineffective in responding to the most contentious aspects of China's industrial policy.

Table 2: WTO Cases Brought by the United States Against China

No.	Title	Request for Consultations	Panel Report	Appellate Body Report	Compliance Status
DS309	Value-Added Tax (VAT) on Integrated Circuits (Semiconductors)	March 18, 2004	Mutually agreed solution October 6, 2004		China agreed to eliminate the VAT refunds to firms producing integrated circuits
DS340	Measures Affecting Imports of Automobile Parts	March 30, 2006	July 18, 2008	December 15, 2008	China repealed the challenged measures in September 2009
DS358	Certain Measures Granting Refunds, Reductions, or Exemptions from Taxes and Other Payments	February 2, 2007	Mutually agreed solution December 17, 2007		China agreed to eliminate challenged subsidies
DS362	Measures Affecting the Protection and Enforcement of Intellectual Property Rights	April 10, 2007	January 26, 2009; adopted March 20, 2009	N/A	China announced it has fully complied with the WTO ruling in March 2010
DS363	Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products	April 10, 2007	August 12, 2009	December 21, 2009	China agreed to implement the WTO ruling; the United States and China will negotiate a timeline for China to comply
DS373	Measures Affecting Financial Information Services and Foreign Financial Information Suppliers	March 3, 2008	Mutually agreed solution December 4, 2008		China issued new regulations for foreign financial news services and named a new, purportedly independent, regulator

Table 2: WTO Cases Brought by the United States Against China—Continued

No.	Title	Request for Consultations	Panel Report	Appellate Body Report	Compliance Status
DS387	Grants, Loans, and Other Incentives (Famous Brands)	December 19, 2008	Mutually agreed solution December 18, 2009		China confirmed it has taken steps to eliminate all of the export-contingent benefits at issue
DS394	Measures Related to the Exportation of Various Raw Materials	June 23, 2009	Panel established December 21, 2009; report pending		
n/a	Measures Imposing Countervailing and Antidumping Duties on Grain Oriented Flat-Rolled Electrical Steel ¹⁹³	September 15, 2010	Request for consultation filed; no panel established yet		
n/a	Measures Affecting U.S. Suppliers of Electronic Payment Services ¹⁹⁴	September 15, 2010	Request for consultation filed; no panel established yet		

Source: WTO and U.S. Trade Representative; compiled by Terence P. Stewart and USCC staff.¹⁹⁵

Table 3: WTO Cases Brought by China Against the United States

No.	Title	Request for Consultations	Panel Report	Appellate Body Report	Compliance Status
DS252	Definitive Safeguard Measures on Imports of Certain Steel Products	March 26, 2002	July 11, 2003	November 10, 2003	United States terminated all safeguard measures subject to the dispute in December 2003
DS368	Preliminary Anti-dumping and Countervailing Duty Determinations on Coated Free Sheet Paper from China	September 14, 2007	Negative U.S. International Trade Commission determination terminated the countervailing duty investigation, which rendered continuation of this case unnecessary		
DS379	Definitive Anti-dumping and Countervailing Duties on Certain Products from China	September 19, 2008	October 22, 2010		WTO panel upheld the right of the United States to impose both antidumping duties and countervailing duties; the panel also found in favor of the United States on the majority of other issues in the case ¹⁹⁶

Table 3: WTO Cases Brought by China Against the United States—Continued

No.	Title	Request for Consultations	Panel Report	Appellate Body Report	Compliance Status
DS392	Certain Measures Affecting Imports of Poultry from China	April 17, 2009	Panel established September 23, 2009; interim report leaked to the press, June 2010		WTO interim ruling found United States in violation of WTO principles
DS399	Measures Affecting Imports of Certain Passenger Vehicle and Light Truck Tires from China	September 14, 2009	Panel established March 12, 2010; report pending		

Source: WTO; compiled by USCC staff.

The United States has a record of winning in the cases it has initiated against Chinese practices that violate its WTO commitments, but some of the most problematic issues in the U.S.-China trade relationship do not appear to be solvable using the WTO process. As Alan W. Wolff, co-chair of international trade practice at the law firm of Dewey & LeBoeuf, told the Commission, “not all matters that are of trade concern to the United States are the subject of dispute settlement cases.”¹⁹⁷ Robert E. Lighthizer, a deputy U.S. trade representative during the Reagan Administration, concurred, saying that the “WTO dispute settlement process is not designed to address the type of systemic noncompliance we see in China.”¹⁹⁸

Furthermore, as Mr. Wolff argued in his testimony, there are several difficulties in assessing success in dispute settlements:

*To be sure, when a case is brought and runs through to conclusion in terms of a judgment or a settlement, and USTR reports China’s compliance, that is one measure of success. But there is only one sure way to judge whether a dispute is satisfactorily concluded, and that is the effect on sales of products or services to which the complained-of restriction applied. In the case of auto parts, where the U.S. won its case, it would be interesting to ask whether China’s restrictions may have served their purpose, with the favorable WTO result coming too late to reverse the damage to U.S. commercial interests. The same is true of local content or technology transfer requirements or applied to investments. The requirements may be lifted after they have had the desired effect. Even then, the case may have resolved only part of the problems faced. The United States has had some ‘wins’ in the area of IP [intellectual property] enforcement, but the Chinese market is still saturated with pirated software and DVDs.*¹⁹⁹

Another obstacle to defending U.S. interests at the WTO is represented by the cases that have not been brought because many U.S. industries fear retaliation from China for promoting a case brought by the Office of the U.S. Trade Representative.²⁰⁰ As a

consequence, WTO cases brought by the United States against China's barriers to trade have been few and, since they are industry specific, they have failed to address the larger aspects of China's industrial policies that U.S. companies find most trade distorting, such as systemic subsidies and currency undervaluation.

The Office of U.S. Trade Representative's *2009 Report to Congress on China's WTO Compliance* noted that China continues to limit market access for non-Chinese-origin goods and foreign services suppliers while offering substantial government resources to support Chinese industries and increase exports.²⁰¹ In fact, Gilbert Kaplan, president of the Committee to Support U.S. Trade Laws, argued in his testimony before the Commission that WTO challenges to China's trade-distorting measures "are a drop in the bucket compared to the vast arsenal of market intervention tools that the Chinese government has at its disposal—including ownership over most key raw materials, land, energy, and capital, and complete control over the exchange rate."²⁰²

The U.S. trade deficit with China has become so intractable, and China's violation of trade rules so systemic, that even such advocates of China's WTO membership as C. Fred Bergsten have argued that the United States should consider tariffs on China if other methods fail.²⁰³ Mr. Lighthizer testified that in the face of China's consistent violation of trade rules and principles, imposing a penalty on China, even though it may violate the WTO rules, "may be the only way to force change in the system, to prompt China to truly live up to the letter and the spirit of its WTO obligations, and to put in place a sustainable and mutually beneficial trade relationship."²⁰⁴

Currency Manipulation and Adjudication under the WTO

As noted elsewhere, the United States has tried to address the RMB's undervaluation through bilateral negotiations, but the results have been mixed (for a discussion of China's currency policy, see chap. 1, sec. 1, of this Report). Accordingly, there is a growing call from experts and policymakers for the United States to take its complaint against China's currency manipulation to a formal WTO dispute settlement panel.

Article XV of the General Agreement on Tariffs and Trade (GATT), entitled "Exchange Arrangements," says that when disputes between signatory countries involve questions about balance of payments, foreign exchange reserves, or exchange arrangements, GATT countries shall "consult fully with the International Monetary Fund [IMF]" and shall accept the IMF's determination as to matters of fact and as to whether a country's exchange arrangements are consistent with its obligations under the IMF Articles of Agreement.* GATT Article XV also says, in paragraph 4, that coun-

*The IMF's Article IV: The IMF Article IV, as revised in 1978, said that countries should seek, in their foreign exchange and monetary policies, to promote orderly economic growth and financial stability and should avoid manipulation of exchange rates or the international monetary system to prevent effective balance of payments adjustment or to gain unfair competitive advantage over other members. The IMF can exercise "firm surveillance," but it cannot compel a country to change its exchange rate. Nor can it order commercial foreign exchange dealers to change the prices at which they trade currencies. For more information, see Jonathan E. Sanford, "Currency Manipulation: The IMF and WTO" (Washington, DC: Congressional Research Service Report for Congress, January 26, 2010), pp. 1-2, http://assets.opencrs.org/rpts/RS22658_20100126.pdf.

tries “shall not, by exchange action, frustrate the provisions of this agreement nor, by trade action, the intent of the provisions” of the IMF Articles of Agreement.²⁰⁵

Traditionally, the term “exchange agreements” was seen as referring (as it did when the GATT was created in 1947) to “currency controls, exchange licenses, transaction taxes and other official actions that limit a potential purchaser’s ability to get the foreign exchange needed to purchase goods from abroad.”²⁰⁶ In recent years, however, the IMF has broadened the meaning of this term, using it in the context of “whether a currency will float in value or be pegged to another currency.”²⁰⁷ As a recent Congressional Research Service report to Congress explains:

There has never been a definitive ruling by the GATT or WTO on the meaning of Article XV, including how provisions of the GATT agreement might be frustrated by exchange action. Some might argue that currency undervaluation raises the price of imports in a way that unilaterally rescinds tariff concessions approved during multilateral trade talks.

*Accordingly, a case could be made that the WTO should use the broader meaning of the term ‘exchange arrangements’ and take currency valuation arrangements into account in its dispute settlement process.*²⁰⁸

Of course, should the United States bring a WTO case on currency, there is no guarantee of success. Moreover, as Mr. Lighthizer testified before the Commission, “[I]t is not clear that ‘winning’ a case at the WTO would actually have a significant impact on China’s currency policy. China would undoubtedly spend years resisting efforts to persuade it to comply with such a ruling—just as it already resists calls to comply with its other WTO obligations.”²⁰⁹

Terence P. Stewart testified that the United States would not need to wait for a formal determination from the IMF that China is manipulating its currency before bringing a WTO case. He reasoned that the United States has several “viable claims . . . to challenge China’s unfair currency practices through the WTO dispute settlement system,” including that the undervaluation of China’s currency “constitutes a prohibited export subsidy within the meaning of various GATT articles and WTO Agreements, . . . violates China’s obligations under the International Monetary Fund’s Articles of Agreement, and . . . nullifies and impairs benefits accruing to the United States [under the WTO agreements].”²¹⁰

Other experts testifying at the Commission’s June 9 hearing disagreed. According to Mr. Wolff, the current WTO provisions have not been seen as an effective counter to currency undervaluation.²¹¹ James Bacchus, former chairman of the Appellate Body of the WTO, concurred, saying, “Obviously, there is considerable concern in the United States, and elsewhere in the world, with how Chinese currency practices affect the terms of trade. To me, that is one issue that would be best resolved through negotiation, and not litigation.”²¹²

The possibility has also been raised of designating China’s undervalued currency as an export subsidy and bringing relief under

U.S. countervailing duty law. This route, too, is controversial. The WTO Agreement on Subsidies and Countervailing Measures (“SCM Agreement”) defines a countervailable subsidy as containing three elements: (1) There must be a financial contribution, (2) there must be a benefit, and (3) there must be specificity.* This exact definition of a countervailable subsidy is incorporated in U.S. Unfair Trade laws at § 771(5) and (5A) of the Tariff Act of 1930.²¹³

Those calling for labeling China’s currency policy a countervailable subsidy argue that all of the legal criteria necessary for the imposition of countervailing duties are met: The Chinese government, through its currency practices, makes a financial contribution that provides a benefit that is specific to exporters and certain other groups of Chinese manufacturers.²¹⁴

Those opposed to using countervailing subsidy law see the situation differently. According to the U.S.-China Business Council, whose members include U.S.-based corporations with facilities in China, since “an exchange rate applies to all companies in a country’s economy, the application of CVDs [countervailing duties] for this purpose would diverge with the specificity requirement under the WTO rules. Since currency policy does not involve the transfer of anything of tangible value from the government, use of CVDs in this manner would also be contrary to the financial-contribution requirement under WTO rules.” The U.S.-China Business Council also argues that currency policy cannot be considered a prohibited subsidy under WTO rules, because “its benefit is not contingent on exportation nor does it require use of domestic goods.”²¹⁵

The issue was recently brought before the U.S. Department of Commerce in two related countervailing duty petition cases targeting imports of aluminum extrusions and coated paper from China. Both petitions included allegations that undervaluation of the RMB constitutes a countervailable subsidy. On August 31, 2010, in tandem with a preliminary determination that Chinese exports of aluminum products were unfairly subsidized, the Department of Commerce announced that it rejected the “currency as subsidy” argument “because the allegations made by domestic producers do not meet the statutory standard for initiating an investigation under the requirement that benefits provided under China’s unified foreign exchange regime be specific to the enterprise or industries being investigated.”²¹⁶ In a memo to Deputy Assistant Secretary for Import Administration Ronald K. Lorentzen, the International Trade Administration found that:

China’s currency regime is broadly available across the Chinese economy to all firms that exchange foreign currency and thus does not single out any enterprise, industry or group thereof. . . . Given that all enterprises and individuals in China that convert allegedly overvalued foreign currencies into RMB are recipients of the alleged subsidy, . . .

*There are four types of “specificity” within the meaning of the SCM Agreement: (1) Enterprise specificity: A government targets a particular company or companies for subsidization; (2) Industry specificity: A government targets a particular sector or sectors for subsidization; (3) Regional specificity: A government targets producers in specified parts of its territory for subsidization; (4) Prohibited subsidies: A government targets export goods or goods using domestic inputs for subsidization. For more information, see WTO, *Subsidies and Countervailing Measures: Overview*, “Agreement on Subsidies and Countervailing Measures (‘SCM Agreement’).” http://www.wto.org/english/tratop_e/scm_e/subs_e.htm#fntext1.

*Petitioners have not sufficiently supported their claim that the undervaluation of the RMB is specific to any enterprise, industry, or group thereof.*²¹⁷

China's currency undervaluation, and the possibility of addressing it through a WTO case, remains the subject of intense debate.

Implications for the United States

China's lack of compliance in several important areas continues to frustrate the effective application of WTO rules to all members and perpetuates trade imbalances. There are two overarching implications of this noncompliance for the United States. First, China promotes industrial policies that manipulate trade rules to benefit domestic firms to the detriment of American and other foreign competitors. Second, China protects many domestic industries through an increasingly restrictive investment regime and export restrictions. This severely impedes the ability of U.S. companies to export to the Chinese market and to compete effectively with Chinese companies.

The wide variety of subsidies and other government-supplied advantages enjoyed by Chinese companies lowers their production costs, enabling China's domestic producers to sell at artificially low rates and to discount exports. China's delay in joining the WTO Agreement on Government Procurement, as it previously committed to do, also places U.S. companies at a disadvantage. U.S. firms are largely excluded from Chinese government procurement contracts, which comprise a significant market, while Chinese companies enjoy the advantages of unimpeded market access in the United States.

U.S. support for China's accession to the WTO was premised not only on achieving economic benefits for the United States, a goal that has had mixed results, but also on achieving political and civil change in China. This goal, too, has not been realized. Although the Chinese people today on average are more prosperous and enjoy a few more personal freedoms, the hope that WTO membership and a move to a more market-oriented economy would force the government to foster political and economic reform remains unfulfilled. The authoritarian Chinese Communist Party remains fully in control of all sectors of economic and civil life. The Internet, once touted as a tool for breaking the totalitarian control of the party over the people, has instead been subverted by the state to promote its policies. (See chap. 5 of this Report for an in-depth look at China's use of the Internet). Similarly, the Chinese government's selective compliance with WTO rules perpetuates the party's rule and provides China's exporters with unfair advantages over China's trading partners, particularly the United States (see also chap. 1, sec. 1, of this Report).

Conclusions

- Since China's accession to the WTO in 2001, the annual U.S. current account deficit with China has grown from \$89 billion in 2001 to \$264 billion in 2009. Predictions of a more balanced trade relationship between the two countries as a result of Chi-

na's membership in the WTO have proven false. Since China's entry into the WTO in 2001, the United States has run a cumulative deficit in goods with China of over \$1.76 trillion.

- Predictions that China's WTO accession would lead to the transformation of China's authoritarian government and enhance U.S. national security have not been borne out.
- Though China's implementation of its WTO commitments has led to a reduction in tariffs, the elimination of some nontariff barriers, and improved market access for some U.S. companies, in other areas significant problems persist. These can be traced to China's pursuit of policies that rely on trade-distorting government intervention intended to promote China's domestic industries and protect them from international competition.
- China, the biggest producer of rare earth elements in the world, has introduced measures aimed at restricting exports to foreign markets, to the detriment of foreign producers of a variety of cutting-edge technologies, including green and clean technologies and weapons systems. Such export restrictions provide an unfair advantage to Chinese technology producers.
- China's progress toward market liberalization has slowed in some sectors and has been reversed in others, such as government procurement and financial services.
- The U.S. government has filed a variety of WTO cases against China's barriers to trade. These WTO cases, while important, frequently fail to deal with the underlying causes of the U.S.-China trade deficit. WTO dispute resolution may be a poor tool for addressing such issues as China's currency manipulation and the trade-distorting aspects of China's industrial policy.