

Testimony of Gary C. Martin, President and CEO, North American Export Grain Association

For the hearing by the

US-China Economic and Security Review Commission

On February 3 and 4, 2005

China and the WTO: Assessing and Enforcing Compliance

Thank you for the opportunity to again address the Commission with regard to China's compliance with the commitments made in connection with its accession to the World Trade Organization (WTO). NAEGA, established in 1912, is a not-for-profit trade association comprised of private and publicly owned companies and farmer-owned cooperatives involved in and providing services to the bulk grain and oilseed exporting industry. NAEGA member companies ship practically all of the bulk grains and oilseeds exported each year from the United States. For the North American Export Grain Association, my primary responsibility is to achieve a mission that seeks to promote and sustain the export of grain and oilseeds from the United States. Our objective of working jointly to foster a grain and oilseed export industry that provides the best environment for all stakeholders – from producer to consumer, guides our activity. Importantly our mission and this objective are founded in NAEGA Membership's commitment:

“to integrity in a commercial environment supported by free trade and competition in commerce involving grain and other agricultural products; to eliminate abuses relative thereto; to eliminate or secure freedom from unjust, unlawful and oppressive exactions in commerce; to promote certainty in the customs and usages of trade and commerce; to promote a more enlarged and friendly exchange among persons engaged in business; and to cooperate to the fullest extent practicable with all governments, governmental departments, governmental and private corporations, partnerships, associations and groups with an interest in providing for global food security and efficient international commerce.”

NAEGA acts from offices in Washington D.C., and in markets throughout the world.

From the perspective of the US grain and oilseed export industry, China is one of our top priority growth markets and because its population and economic growth a major influence in many related markets. We see a successful Chinese effort to meet its WTO commitments as critical to the future of the WTO and the US grain and oilseed export industry.

China is now more than half-way through its commitment phase-in period. At this time China should have graduated from the early period of its implementation efforts. China has made progress in important areas, particularly in tariff reduction; revising existing laws and drafting and passing new ones to comply with its WTO requirements; and educating its officials and companies about its WTO obligations. China should be recognized for its efforts that have resulted in tangible improvements in market access. Given the sweeping nature of China's December 2001 market access commitments, this progress was to be expected.

The elevated meetings of the U.S. and Chinese officials have made significant progress in several lagging areas of implementation. However, US agricultural interests have expressed and should continue to express growing concern regarding the progress of China's WTO implementation efforts.

China's WTO commitments to reduce both tariff and non-tariff barriers in the agricultural sector have met with mixed results. There has been welcome progress in some key areas such as tariff reductions. Unfortunately, however, many non-tariff barriers continue to limit the progress anticipated from China's WTO membership.

China has made some progress in addressing a range of problems with the implementation of the promised TRQ system, including a lack of transparency, delay in the announcement of quotas, granting of insignificant and uneconomic quotas, imposition of restrictions that are not required of domestic producers or merchants, and other unnecessary restrictions.

China has also removed, to a degree, uncertainty regarding biotech regulations and the issuance of permanent safety certificates for biotech products. The progress on certification of US genetically modified agricultural exports included a political commitment by the Chinese to not disrupt US soybean exports.

Today I would like to focus on two specific areas where China fails to meet its WTO obligations. First, while China has eliminated or reduced some tariff barriers, the benefits from these actions can be quickly offset by continued non-tariff barriers that restrict trade into China, create significant marketplace uncertainty, and discourage further foreign investment. Second, we are concerned with the failure of China to eliminate practices that result in significant export subsidies for agricultural products, particularly corn.

Non-Tariff Trade Barriers

Among the agricultural product restrictions that China imposes are additional standards and actions on imports of agricultural products that:

1. Are applied without prior notice and geographic consistency;
2. Fail to provide for comment period and time provisions for trading partners to institute practices to readily comply;
3. Encourage and support Chinese firms to avoid contractual commitments;
4. Inappropriately discriminate against specific private entities through the broad-based imposition of company-specific trading bans (blacklisting); and
5. Result in unjustified management and delay of the issuance of Permits for Quarantine Inspections to control imports for political or economic reasons.

Soybean traders in particular have reported significant restrictions on exports of products to China stemming from the General Administration of Quality Supervision, Inspection and Quarantine of the People's Republic (AQSIQ). Although China removed soybean import quota control in 1999, we believe the Chinese government continues to control

import volume through WTO-inconsistent methods such as the use the AQSIQ import permits. AQSIQ issuance of permits has resulted in significant commercial uncertainty and, in some cases, has placed U.S. foreign investment in the Chinese agricultural sector at risk.

We should acknowledge the likely impacts of such inappropriate governmental actions. As I hope you are aware, NAEGA, the National Oilseeds Processors Association and similar trade associations representing from Brazil and Argentina are very concerned about the regulatory and enforcement actions of the Chinese authorities. We are ultimately concerned by the uncertainty that results from enforcement of official requirements that: do not recognize the need to facilitate trade; are not based on science; and lack necessary transparency and advance notice, encourage a lack of contract sanctity and greatly reduce the predictability of trade. Contract integrity and predictability, prior to shipment, of the commercial and official acceptance of commodities upon arrival are overarching prerequisites to successful international agricultural commodity trade.

It is obvious that a number of factors influence defaults and the predictability of trade. These include cultural and ethical issues ingrained in business practices or customs regarding contractual obligations. Other problems include restrictive currency regulations that inhibit hedging and in some cases outright prohibitions against hedging, and lack of familiarity with international trading rules and arbitration procedures along with the consequences of failing to comply with these universally acceptable precepts. Importantly all trade participants must be adequately financed to insure contract integrity can be maintained. Further, since the Chinese Government determines the credit policy of China any denial of credit to a private sector has a direct impact on the efforts to perpetuate sound commercial practice and contract sanctity. In the case of China, practices that appear to put in place to manage trade flows and that are not consistent with WTO obligations are a major contributor to a lack of predictability and lead, in some cases, to a lack of contract performance.

While the precise mechanism used by the Government of China to manage imports has a tendency to change quickly, I would like to point out a recent notice from AQSIQ that articulates and codifies inappropriate regulatory authority.

AQSIQ Decree 73, we fear, unilaterally imposes new and additional standards to imports of all plant and animal agricultural products and expressly rejects the sanctity of international sampling and testing procedures that have been developed and respected over time. China's issuance of the new measure, "*Items on Handling the Review and Approval for Entry Animal and Plant Quarantine*", was not notified to the WTO and maintains the requirement that Quarantine Import Permits (QIP's) be approved prior to signing contracts. This is of significant concern to all U.S. agricultural exporters. The measure provides AQSIQ with blanket authority to annul or void import permits in the case of a government issued warning or ban and also requires quarantine requirements specified in QIP's be written into contracts.

On June 16, 2004, China's quarantine and inspection agency, the General Administration of Quality Supervision, Inspection, and Quarantine (AQSIQ), issued revised regulations for importation of soybeans and other products subject to the quarantine process. The decree became effective on July 1, 2004. The new regulations, known as Decree 73 (Items on Handling the Review and Approval for Animal and Plant Entry Quarantine), were not properly notified to the World Trade Organization (WTO). To date, China has yet to properly identify, as well as support scientifically, the phytosanitary risks that require implementation of such regulations. In our estimation, Decree 73 places exporters in an unfavorable commercial position relative to domestic producers in China.

While Decree 73 extended the validity of quarantine import permits (QIP) from 3 months to six months in accordance with an agreement reached during the April 2004 meetings of the U.S.-China Joint Commission on Commerce and Trade (JCCT), Decree 73 included additional burdensome requirements that constrain U.S. exporters' ability to export grain and oilseeds to China, and that create uncertainty for U.S. producers.

Following are the specifics our concerns with AQSIQ decree 73:

1. Requires exporters to assume the risk of non-compliance with Chinese laws. Decree 73 requires all contracts for importation of soybeans and other products to include Chinese inspection and quarantine requirements as a contract term. Further, the contract must stipulate that entry of goods is dependent on whether the goods comply with relevant Chinese laws and food safety regulations. Such requirements are inconsistent with standard international trading practices in that exporters of agricultural products are forced to assume the risk of non-compliance with foreign standards. Even Chinese exporters do not face those requirements in export markets. Under an international commercial sale, the quality, condition, and specification of the goods are determined when the goods are shipped, and therefore, the risk is transferred from the exporter to the importer upon shipment of the product, not upon discharge in the foreign port. Under these requirements, the importer can reject shipments if the Chinese authorities determine the product does not comply with Chinese laws, creating a great deal of uncertainty for U.S. suppliers.
2. Creates zero tolerance level for GMO presence. Decree 73 requires that a safety certificate issued by the Ministry of Agriculture in China accompany all products of Genetically Modified Organisms. The Ministry only makes certificates available for GMO products that are approved by the Chinese government. The requirement in essence creates a zero-tolerance requirement for any shipments that contain trace elements of non-approved GMO products. Zero-Tolerance standards that apply to many commercially produced agricultural commodities are impossible to meet. The failure to provide for the adventitious presence of GMO events in any shipment results in the strong possibility that trade will be prohibited.

3. QIP applications require identification of supplier. It is not practical to require the importer to list the supplier at the time of application because often the supplier is often changed after the QIP is issued. The exporter is the contracting party with the Chinese importer, not the supplier.
4. Allows for arbitrary revocation of QIPs. Chinese authorities can, at any time, invalidate an import permit in the event of any announcement by the government that forbids entry of the product. Basically, this regulation provides Chinese authorities the license to issue scientifically unfounded bans on U.S. exports of agricultural products, which runs counter to China's obligations under the WTO SPS Agreement and the GATT 1994.

While it is difficult to estimate the costs and other implications of these sort of official actions it should be made clear that while trade and investment is occurring under more uncertain conditions, it is occurring with higher risk premiums built into the existing contracts. I think most of us are aware of one of the most obvious costs when regulations prevent vessel discharge. The potential holdup costs from such circumstances would be substantial. Depending on the size of cargo and port of import, demurrage charges from re-directing a vessel to an alternative destination, quality deterioration and other costs could add up to millions of dollars per held-up vessel.

It is also important to recognize the impact of increases in market volatility that result in even short term disruptions of trade due to inappropriate official enforcement actions. In the U.S. we certainly appreciate the assurances that Chinese officials have provided to our senior U.S. trade officials that Decree 73 will not disrupt U.S. soybean exports to China. However assurances do not remove the risk created by the existence of regulations like Decree 73. For example, the recent problems with shipments of soybeans from South America have had secondary effects on our marketing. Rejection of products from Brazil and Argentina send the U.S. market into a tailspin in terms of price declines created by an unsuspected glut of additional product in the world market. Our consistent experience is that, contrary to such assurances, the short term disruption of trade that results from the combination of an interest in managing trade and the authority described in Decree 73 is not only expensive but can result in the reputation that a market is unreliable. As I discussed earlier, the avoidance of this reputation is important to all market participants.

In addition to the concerns with Decree 73, US interests are harmed by the failure of China to utilize the International Plant Protection Convention and China's use of "zero tolerance" standards that are neither science based nor practical. Fundamentally, China needs to adhere to the WTO Agreement on the Application of Sanitary and Phytosanitary Measures. These various non-WTO complaint measures are causing serious interruptions in cargo contracting and delivery thereby adding unnecessary risk to doing business with Chinese customers and limiting sales of many US agricultural products. The near and long term costs of such actions directly impact US farm income.

As a remedy for these AQSIQ related problems, China should provide for:

- Changes in activities that restrict actions to import quarantine procedures that are science based and compliant with WTO and international conventions and should not impose delays, uncertainties, or commercially discriminatory or commercially unrealistic requirements that inhibit free trade.
- The approvals of import permit requests in a timely and commercially realistic manner.
- Process and communication that ensures that all formalities are transparent, with clear timelines openly promulgated.

Export Subsidies

Since China joined the WTO, we have continued to see reluctance by Chinese officials to comply with WTO rules and abide by the obligations set forth in China's Accession Agreement as they apply to subsidies and preference to agricultural product exports. The WTO-illegal use of export subsidies and discrimination against imports continues to adversely affect U.S. feed grain producers and exporters. Chinese administrative control over pricing and other non-transparent practices often make it difficult to identify and track subsidy practices. Nevertheless two distinct areas of export subsidy for corn can be identified:

Applying the Value Added Tax (VAT) to Imports - It is assumed that upon importation, a VAT of 13% will be applied to the C&F value of corn (approximately \$20/mt). However, PRC domestic corn that ends up in the feed channel has no VAT directly applied (some argue it is applied in the form of VAT on commodity). Recent information from China confirms the VAT is refunded on corn exports. These tax refunds vary but it is clear they often exceed the applied VAT. The fact that traders believe this tax will be applied decreases the likelihood of filling the import TRQ unless world prices are correspondingly lower. And, if the 13% VAT actually is applied, it would certainly be at least a partial violation of WTO principles, if not completely a violation. (In July, 2004, the United States resolved a similar dispute with China in the WTO over semiconductors.)

Additionally, if the Chinese private trade is assessed the VAT on grain imports while state trade imports are VAT-exempt, the private trade clearly would be at a significant price disadvantage in the market. In fact, the state trade which is likely further supported by administratively determined price preferences can completely crowd-out any private sector importing activity and act in a non-transparent manner to export allocated amounts of corn.

Direct Export Subsidies - Due to China's export policy in 2003, it was able to ship a record 16.4 million metric tons of corn into the international market, with much of that volume displacing U.S. sales. While a reduced crop lead to a significant reduction in corn exports in 2004, we anticipate a return in 2005 to an export regime that provides for export prices that are lower than domestic price. Further there again is strong evidence that China will export corn on a non-commercial basis with the aid of export subsidies.

China's explanation of lowering the price of corn for export through the practice of rebating the VAT is not consistent with what is actually happening given that the VAT is

not collected to begin with, or collected fully, as outlined above. However, the overt use of export subsidies has been widely published in the Chinese press and is common knowledge among traders. Again, this is a direct violation of China's obligations under the Accession Agreement.

Recent reports confirm the expectation that China's corn exports will experience a partial revival this year thanks to the central government's policy adjustment. While USDA is estimating 4 million metric tons of Chinese corn exports this year, recent projections from China indicate an export program of 5 million tons. That would be double last year's total corn exports of 2.32 million tons. The China National Grain and Oils Information Centre predicted China's corn harvest to rise 14 per cent to 131.7 million tons in 2004 from 2003, after the area sown with the crop expanded 6 per cent to 25.6 million hectares. China's demand for corn is projected at 126 million tons for the crop year through September 2005, which means this marketing year will be the first time in five years that production exceeds demand.

The situation means China must increase its exports; doing so with the high domestic price level established to support farm income is impossible without government support. Reports from late last week said the government is considering more policies to boost exports in the wake of recent tax rebate increase. Indications are the Chinese government has increased the base price for calculating a rebate of a 13% value added tax to 1,100 Yuan (US\$133) per ton, from the former base price of 860 Yuan (US\$104). In China, the value on which the 13-per-cent is refunded is not based on actual FOB (free-on-board) prices but on fixed prices set by the government, which are usually lower than the FOB prices. The policy change meant exporters tax rebates would be increased by US\$3.77 per ton.

Additional reports indicate that in order to encourage exports and increase farmers' incomes, the government may introduce more measures to support corn exports, including increasing export quotas and waiving railway construction funds in corn transportation charges. Waiving the railway construction charge will lower delivery costs from production bases to ports by 30 per cent, for example 23 Yuan (US\$2.78) per ton in Jilin and 30 Yuan (US\$3.61) in Heilongjiang,

The exemption of construction funds and the administrative practice of providing for acquisition costs at well below market values are a direct subsidy to corn exports.

Japan and South Korea, two of our best customers for US corn are the main export destinations of subsidized Chinese corn.

Working Together to Improve Trade

In the best interest of China and international commerce, China must meet its WTO obligations and improve the import quarantine process and eliminate agricultural product export subsidies. An absence of progress in this regard will lead to the need for WTO dispute settlement cases.

Recognizing that much has been accomplished to date, I would like to urge the

governments of China and the United States to press aggressively forward in their efforts to work collaboratively to reduce unjustified barriers to agricultural imports and identify subsidies so they can be eliminated.

The importance of working with other nations that serve the Chinese market for agricultural products should also be emphasized. The U.S. competes for the Chinese market in many agricultural products including soybeans. However, with a market as large and influential as China, an internationally consistent approach to technical issues that are addressed by the WTO Sanitary and Phytosanitary Agreement and that impact all suppliers will greatly enhance the success of our efforts. For products like soybeans, a multinational strategy that adds to the joint efforts of the governments of China and the U.S. will help to ensure sufficient progress. Ultimately working to achieve international consistency on health and safety issues will support the maintenance of a level playing field for U.S. agricultural products in the Chinese market.

Market participants must acknowledge and address each of these factors. Further, the individual merchants or their trade organizations should consider undertaking a comprehensive and large scale educational effort to familiarize the market participants and government officials with the prevailing trade rules, the protections and expectations of those rules. Governments in particular must be educated to understand the impact of regulation on trade.

China's entry into the World Trade Organization (WTO) brings with it the reciprocal responsibility of adhering to its contractual responsibilities given the extraordinary market privileges inherent in WTO membership. China's WTO membership provides for new and expanded trading opportunities that result in immediate and significant market growth in much of the developed world's consuming markets.

I want to urge our joint actions to work to expand our common understanding and improve conditions of trade. In the event of disputes, we should all work to ensure commercial arbitration awards are honored. In China, regulatory measures must meet WTO standards, necessary financial controls must exist, financing must be provided to allow industry to perform on contracts and export subsidies must be identified and eliminated.

Thank You, I look forward to our ongoing discussion and any questions you may have.

2/2/2005