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China's WTO Compliance and Industrial Subsidies

Introduction

Chairman Wortzel and members of the Commission, I appreciate the opportunity to testify today on the Administration's assessment of China's compliance with its obligations to the World Trade Organization (WTO). This is a subject of considerable importance and a matter of great priority to the Administration, and to the Office of the United States Trade Representative (USTR) in particular, in our capacity as the lead agency with responsibility for trade policy.

I have just returned from nearly two weeks in China. Together with colleagues from the Department of Commerce, we have been engaging our Chinese counterparts in preparation for the next meeting of the Joint Commission on Commerce and Trade (JCCT), scheduled to take place in Washington on April 11. A number of the issues we have been discussing relate to China's WTO compliance, including in the area of subsidies.

As you know, at Ambassador Portman's direction, USTR recently led an interagency "top-to-bottom" review of U.S. trade policy with China. When Ambassador Portman took over as the United States Trade Representative, he felt strongly that it was time to revisit how the United States approached its trade relationship with China. Having completed the review, our view is that U.S.-China trade relations are entering a new phase in which greater accountability on China's part and greater enforcement on the Administration's part are needed.

We enter this new phase firm in our belief that, while our bilateral trade relationship has been largely beneficial for both the United States and China, it is not sufficiently balanced in the opportunities it provides. As a result, though our overall goals and objectives remain the same, some recalibration in the way we respond to problems is required. We have a complicated task as we seek to achieve the dual objectives of solving specific, immediate problems – resorting to more muscular enforcement mechanisms where necessary – and encouraging the long-term transformation of China into a more rules-based, open economy. We believe that the key to achieving those objectives is treating China as a fully accountable stakeholder in the international trading system and insisting that China play a constructive role commensurate with its commercial heft and the enormous benefits that it has gained from its participation in the global trading system.

A New Phase in U.S.-China Trade Relations

Thirty years ago, China was a nation mostly closed to international commerce. Today, it is the world's third largest trading power. China's emergence over this period as a major international player has not only redefined the global trading system, but also has had far-reaching economic and political impact on China, the United States, East Asia and the world.

The trade relationship between the United States and China has become increasingly central to the economies of both our countries. China's economy has been growing at roughly 10 percent per year for more than two decades, and its growth has been closely tied to the open trade and investment regimes of the major economies of the world. Exports account for 40 percent of China's GDP, and China has depended on the growth of its export sector to spur modernization of its economy and to support improved standards of living. According to Chinese data, the United States market has been the direct recipient of 22 percent of China's phenomenal export growth over the last twenty years. The United States has also derived benefits from the trade relationship. U.S. consumers now have access to a wider variety of less costly goods, and low-cost consumer and industrial goods from China have helped spur U.S. economic growth while keeping a check on inflation. Access to Chinese inputs has helped make U.S. companies more competitive in the global economy. Since 2001, when China joined the World Trade Organization (WTO), U.S. exports to China have grown five times faster than they have to the rest of the world, and China has gone from being the ninth to the fourth biggest export market for the United States. U.S. exports to China increased by an impressive 21 percent in 2005, building on 22 percent growth in 2004 and making China our fastest growing export market among our major trading partners. Together, the United States and China have accounted for roughly half of the economic growth globally in the past four years. Market forces continue to drive broader and deeper economic ties between our two countries.

At the same time, the enormous scope and scale of the changes that have occurred in China's trading posture and in our bilateral trade relationship pose continual challenges. As China's economy and our bilateral trade have grown, our trade relationship has become enormously complex. Features of this relationship – the size of China's consumer base and labor force, for example, or the increasing sophistication of Chinese production – can be both encouraging and a cause for concern at the same time. The relationship lends itself neither to simplistic characterizations nor to simple policy prescriptions.

Overall, despite many positive developments, there is concern that the U.S.-China trade relationship lacks balance in opportunity, as well as equity and durability, with China's focus on export growth and developing domestic industries not being matched by a comparable focus on fulfilling market opening commitments or on the protection of intellectual property rights (IPR) and internationally recognized labor rights.

In our "top-to-bottom" review, the Administration examined the United States' trade relationship with China over the years and concluded that the United States is now entering an important new phase in its relationship with China. We view it as the third phase in that relationship.

The first phase began in 1986 when the United States formally acknowledged China's goals to modernize and integrate itself into the global marketplace by commencing negotiations for China to become a party to the General Agreement on Tariffs and Trade (GATT), or as it was subsequently renamed, the World Trade Organization. That phase lasted for 15 years and was focused on identifying and negotiating the kinds of commitments China needed to make in order to gain admission to the WTO. Great strides were made during that first phase in modernizing and strengthening our bilateral trade relationship. By the end of this period, China had made enough progress in its own program for reform and opening that it was able to agree to lower trade barriers in virtually every sector, protect intellectual property rights, and adopt special rules to address subsidies and other forms of state ownership and control of economic resources.

The second phase began in December 2001, when China joined the WTO. While its accession agreement called on China to implement a large number of commitments immediately as a condition of membership, China was also allowed to implement many other, often significant commitments over a period of years – including not only scheduled reductions in tariff rates, but also the elimination of numerous non-tariff barriers and expansions in market access for a variety of service sectors. During this transition period, U.S. trade policy towards China was largely focused on ensuring that China implemented these specific commitments, and our view of China's performance as a trading partner was largely based on how fully and timely it implemented them. Spurred on by our vigilance and engagement, China made progress in implementing many of its commitments. For example, China lowered its tariffs on the goods of greatest value to the U.S. economy from an average of 25 percent to an average of 7 percent, while removing or reducing numerous non-tariff barriers such as quotas and licensing requirements. China also followed through on its important commitments to make trading rights available to foreign enterprises and individuals, and to allow foreign suppliers to engage in distribution within China. In addition, China created new opportunities for many foreign companies in a range of service sectors.

It has now been more than four years since China joined the WTO, and as our "top-to-bottom" review report concluded, we are entering a new – third – phase in the U.S.-China trade relationship. China's transition period as a new participant in the international trading system – and, in particular, the WTO – has now come to a close, and China is expected to act and will be treated as a fully accountable participant in and beneficiary of the international trading system. Like any stakeholder, China must find a way to pursue its own self-interest while also adhering to, and helping to shape, the policies and institutions that undergird its own growing prosperity and the prosperity of its trading partners.

Challenges in the Relationship

After four years of WTO membership, China has a track record as a WTO member, and that track record is decidedly mixed. The commitments that were easiest to fulfill have largely been fulfilled, and those still outstanding will require a more serious level of bilateral and multilateral focus and attention.

In USTR's annual Report to Congress on China's WTO Compliance issued in December 2005, we provided a detailed assessment of China's first four years of WTO membership. We concluded that China has not yet fully embraced the key WTO principles of market access, non-discrimination and national treatment, nor has China fully institutionalized market mechanisms and made its trade regime predictable and transparent. While China has made some important progress in implementing specific commitments from its accession agreement, we found that it continued to use an array of industrial policy tools in 2005 to promote or protect favored sectors and industries, and these tools at times collide with China's ongoing WTO obligations. We also catalogued specific WTO compliance problems that we are encountering, while highlighting certain areas that continue to generate the most significant problems, including inadequate enforcement of laws, particularly in the area of intellectual property rights, and problems associated with industrial policies, restrictions on market access for services, non-tariff barriers affecting trade in agriculture, and an overall lack of transparency in the regulatory environment.

On April 19 and 21, WTO Members will meet in Geneva to conduct the first Trade Policy Review (TPR) of China. WTO rules require that the four Members with the largest share of world trade be reviewed every two years, with less frequent reviews of other Members. The WTO Secretariat prepared a nearly 300-page report on China's trade policy regime, noting China's many reforms and the multitude of challenges that it still faces. The report projects that China will need to create over 100 million jobs in the next decade as it continues to restructure its economy, especially its agriculture sector and state-owned enterprises. This will present major challenges for China, and could have a significant impact on other Members. The Report also notes the need for policy realignments to prevent misallocation of resources and overinvestment in certain sectors. The United States has submitted more than 200 questions in connection with China's TPR, including many addressing China's subsidies practices. In accordance with WTO rules, we look forward to receiving written responses from China. This TPR provides an important opportunity for the United States and other WTO members to seek an accounting from China with respect to trade practices of concern to us. China participated actively in the TPR conducted of the United States just last month, and we are looking forward to engaging with China during its review.

Among the many challenges we are facing in our bilateral trade relationship with China, the area of intellectual property rights is especially significant. While China has made noticeable improvements to its framework of laws and regulations, the general lack of effective IPR enforcement remains an enormous challenge. At the JCCT in 2004, China committed to significantly reduce counterfeiting and piracy. Nearly two years have gone by and the results demonstrate isolated − but not significant − progress. For example, U.S. trademark owners have met with some promising early successes in a campaign to impose liability on the landlords of markets that are notorious for selling fakes, such as the Silk Market in Beijing. At the same time, there are troubling signs. In 2005, for instance, the share of IPR infringing goods seized by U.S. Customs originating in China increased to 69 percent from 64 percent in 2004, despite China's declaration at the 2005 JCCT that exportation is a criminal offense. Moreover, China has not yet met its 2005 JCCT commitment to issue regulations on transferring IPR cases from customs officials to criminal prosecutors. This may help to explain why we have not seen prosecutions of exporters of counterfeit and pirated goods.

In other IPR areas, we have also not seen significant progress. For example, while the use of pirated software on Chinese government computers has declined since China's 2004 and 2005 JCCT commitments to ban illegal software in government offices, we have not seen clear evidence that the problem has been fully resolved. There is also widespread software piracy outside the government in China, which China has begun to take steps to confront. We would like to continue working with China to achieve success in these areas. Similarly, given the widespread availability of pirated movie DVDs and music CDs in stores and on streets across China, we have urged China to remedy this problem once and for all through permanent plant closures, criminal prosecutions and on-going monitoring and enforcement. China agreed to step up criminal enforcement, but we have seen only a very small increase in the number of criminal copyright cases. We stand ready to cooperate toward this end. The Internet is another means that has also been used extensively in China and elsewhere for IPR-infringing purposes. China agreed at the JCCT last year to submit the legislative package necessary to join the WIPO Internet Treaties to its National People's Congress in June of this year. We have worked with and will continue working with China on the details of this very important package.

Last year, USTR concluded an out-of-cycle review under the Special 301 provisions of U.S. trade law, and elevated China to the Special 301 "Priority Watch" list. We set forth a comprehensive strategy for addressing China's ineffective IPR enforcement regime, including the possible use of WTO mechanisms, as appropriate. In October 2005, the United States submitted a transparency request to China under Article 63.3 of the WTO Agreement on Trade-Related Aspects of Intellectual Property rights. The U.S. request, made in conjunction with similar requests by Japan and Switzerland, sought detailed information from China on its IPR enforcement efforts over the last four years. China has provided the United States with some information, but not a complete response. We will release our Special 301 Report this year according to the deadlines Congress has established.

We have also seen China increasingly resort to industrial policies that limit market access by non-Chinese origin goods or services or rely on government resources to support increased exports. The objectives of these policies are to protect less-competitive domestic industries and support the development of Chinese industries higher up the economic value chain than those industries that currently make up China's labor-intensive base. In 2005, examples of these industrial policies were readily evident. They included the issuance of regulations on auto parts tariffs that discourage the use of imported parts, the telecommunications regulator's interference in commercial negotiations over licenses with IPR holders in the area of 3G standards, the pursuit of unique national standards in a number of high technology areas that could lead to the extraction of technology or intellectual property from foreign rights-holders, draft government procurement regulations mandating purchases of Chinese-produced software, a new steel industrial policy that calls for the state's management of nearly every major aspect of China's steel industry, continuing export restrictions on coke, removal of provisions addressing government monopolies from the current draft of the anti-monopoly law, and excessive government subsidization benefiting a range of domestic industries in China (as discussed more fully below). We believe that such policies not only harm U.S. and third-country competitors, they redound to China's detriment as well. Moreover, some of these policies appear to conflict with China's WTO commitments. We are taking a hard look at them and will not hesitate to take action at the WTO if such action appears warranted.

In the area of services, concerns in many sectors remain, largely due to arbitrary and non-transparent policies, delays in the issuance of regulatory measures, and China's use of entry threshold requirements that exceed international norms. Indeed, Chinese regulatory authorities continue to pose obstacles to the efforts of U.S. providers of distribution, express delivery, direct selling, franchising, insurance, construction and engineering, telecommunications and other services to achieve their full market potential in China.

Agriculture is a high priority of the Administration's trade relations with China. While China is one of our farm sector's best customers, the record demonstrates that China does not always base its food safety decisions on science, as evidenced by its continued ban on U.S. beef. Last year, the United States and China initialed a Memorandum of Understanding to facilitate cooperation on animal and plant health safety issues. However, agricultural trade with China remains among the least transparent and predictable of the world's major markets. Capricious practices by Chinese customs and quarantine officials can delay or halt shipments of agricultural products into China, while sanitary and phytosanitary standards with questionable scientific bases and a generally opaque regulatory regime frequently bedevil traders in agricultural commodities.

Transparency concerns cut across sectors, as China's various regulatory regimes continue to suffer from systemic opacity, frustrating efforts of foreign – and domestic – businesses to achieve the potential benefits of China's WTO accession. Although China has taken steps to improve transparency across a wide range of national and provincial regulatory authorities, particularly at the Ministry of Commerce, many other ministries and agencies have made less than impressive efforts to improve their transparency. U.S., Chinese and other participants in commercial activities across China would benefit greatly if China fully adhered to its WTO commitment to maintain an official journal dedicated to the publication of all trade-related measures, and provided ample opportunity for prior public comment before such measures became effective.

Overall, while China has a more open and competitive economy than 25 years ago, and China's WTO accession has led to the removal of many trade barriers, there are still substantial barriers to trade that have yet to be dismantled. If China is to complete the implementation of its WTO commitments and institutionalize market-oriented reforms, it will need to eliminate mechanisms that allow government officials to intervene in the Chinese economy in a manner that is inconsistent with market principles. Despite its remarkable transformation over the past quarter century, China continues to suffer from its command economy legacy. As a result, Chinese economic policy-making often operates in a way that prevents U.S. businesses from achieving their full potential in the China market. As U.S. expectations shift from the establishment of basic regulations and implementation of specific WTO commitments to measurable improvements in market access for U.S. products and services, there will be decreasing tolerance for Chinese efforts to protect domestic industries. JCCT meetings have provided bilateral opportunities to discuss and find solutions for many issues of particular importance in U.S.-China trade relations. We value the open, productive, problem-solving approach China has taken at the 2004 and 2005 JCCT meetings, and hope that the JCCT will continue to function as a meaningful forum for the resolution of trade frictions.

Subsidies

Article 25.1 of the WTO Agreement on Subsidies and Countervailing Measures (Subsidies Agreement) requires each WTO member to submit an annual notification of all of the subsidies that it maintains. This requirement is especially important for members like China, whose lack of transparency makes independent investigation and assessment very difficult.

China has not yet submitted a single subsidies notification since joining the WTO in December 2001. Last July, at the JCCT meeting held in Beijing, China committed to submit a detailed notification of its subsidies to the WTO by the end of 2005. China made similar promises in formal meetings before the WTO's Council for Trade in Goods and Committee on Subsides and Countervailing Measures (Subsidies Committee) last year. However, China still has not submitted this important − and long overdue − notification.

During the run-up to the April 11 JCCT meeting, the Administration has continued to press China to submit its notification and has made clear to China that government subsidization in China remains a key concern for many U.S. industries. Indeed, we have heard from a range of industries, including some that will testify today, such as the steel and paper industries, about the problems that Chinese government subsidization creates for them. As these industries will also tell you, China's lack of transparency presents enormous challenges in trying to develop comprehensive information about the various types of financial support that China provides to its domestic industries.

To the extent that we are able to develop information on particular subsidies, we have been raising them at the WTO. For example, in October 2004, the United States submitted questions about a number of subsidy programs, including potentially prohibited subsidies, in a WTO filing under Article 25.8 of the Subsidies Agreement, although to date China has not responded to any of those questions. We have also regularly used the China Transitional Review Mechanism (TRM) meetings at the WTO to express our concerns and seek further information.

We have also sought to address subsidies issues in bilateral meetings with China. We recently began a Steel Dialogue with China, and in that context we anticipate addressing the role of the Chinese government, including its provision of financial support, in the restructuring of China's domestic steel industry. We have also discussed subsidies issues more generally in connection with the JCCT Structural Issues Working Group and hope to intensify those discussions once China submits its subsidies notification to the WTO.

Readjusting U.S. Trade Resources and Priorities

The report on our "top-to-bottom" review of the U.S.-China trade relationship recognizes the many ongoing challenges, and opportunities, presented by China's emergence as a major international player. Because of the nature of the challenges, and because it is time to insist that China be held accountable as would any mature partner and responsible stakeholder in the international trading system, the report recommends that U.S. trade resources and priorities be readjusted in a number of ways.

First and foremost, the report calls for strengthening the United States' current focus on China's WTO compliance and adherence to international norms. The report also urges that more focus be put on ensuring that the bilateral trade relationship offers more balanced opportunities and is equitable and durable. The report also cites a need for U.S. trade policymaking to be more proactive and informed by more comprehensive information regarding China's economic trends and developments, with stronger coordination within the Executive branch and between the Executive and Congressional branches. The report further highlights the need for China to participate more fully in the global trading system as a responsible trading partner, and for the United States to remain an active and influential economic and trading power in the Asia Pacific region.

The report goes on to identify six key China trade objectives as we move forward. They include: (1) integrating China more fully as a responsible stakeholder into the global rules-based system of international trade and secure its support for efforts to further open world markets; (2) monitoring China's adherence to international and bilateral trade obligations and secure full implementation and compliance; (3) ensuring that U.S. trade remedy and other import laws are enforced fully and transparently, so that Chinese imports are fairly traded, and U.S. and Chinese products are able to compete in the U.S. market on a level playing field; (4) securing further access to the Chinese market and greater economic reforms in China, beyond what is granted under China's current commitments, to ensure that U.S. companies and workers can compete on a level playing field; (5) pursuing effective U.S. export promotion efforts with special attention to areas of particular U.S. export growth potential in China; and (6) identifying mid- and long-term challenges that the trade relationship may encounter, and seeking proactively to address those challenges.

In the report, USTR lays out a series of actions that will help ensure that the United States is positioned to achieve these objectives. First, USTR will seek to enhance its trade enforcement capacity, along with its capability to obtain and process comprehensive, forward-looking information about the U.S.-China trade relationship. We will also seek to expand our trade resources in Beijing and strengthen interagency coordination and the Executive-Congressional partnership on China trade. In addition, we seek to strengthen, expand and increase the effectiveness of the U.S.-China dialogue on China's needed structural economic reforms and numerous specific issues, such as standards and SPS issues, China's subsidies practices, financial services, telecommunications services, labor, environmental protection, and transparency and the rule of law, among other issues. The Administration recognizes as well the importance of increasing coordination with other trading partners in pursuing these issues and – as evidenced by its coordination with European and Asian partners on IPR and auto parts issues – is already vigorously pursuing such coordination.

Engaging China

Bilateral Engagement

Through sustained and constructive engagement, the United States has contributed greatly to China's integration into the global economy – to the benefit of both countries. Indeed, more has been done by the United States to promote and facilitate China's integration into the international trading system than has been done by any other nation in the world, and the United States will continue to engage China as it continues its transformation. We continue to believe that U.S. interests are best pursued through further opening of the Chinese market, not by closure of U.S. markets.

To ensure that the economic benefits of the U.S.-China trade relationship are protected, and the potential gains are achieved, we must demonstrate that we can cooperate effectively to resolve bilateral issues. Such cooperation was evidenced last year, when the United States and China reached an agreement on textiles, adding much-needed predictability to bilateral trade, to the benefit of producers and consumers. We will continue to seek to work constructively with China, to resolve bilateral challenges and to develop a U.S.-China relationship that has greater equity, durability, and balance of opportunities.

Regional Engagement

Looking beyond the bilateral issues, China can also take actions that demonstrate it is prepared to play a role as a responsible stakeholder in the international economic system commensurate with its commercial heft and with the benefit it has obtained from that system. China should work closely with its partners in regional fora, such as APEC. China needs to play a constructive role in ensuring that the conditions for safe, secure and efficient trade prevail in the region. As both a driver and beneficiary of economic growth in the Asia Pacific region, China has a great incentive in joining with other regional economies to open markets, promote trade security, and build the infrastructure needed to ensure that trade can flow smoothly. It also has powerful incentives to address proactively threats – such as disease and pollution – that do not recognize national borders, but that could have enormously damaging effects on trade – to say nothing of human welfare – if left unaddressed.

It bears mentioning that the United States is also actively seeking to broaden its trade relations with countries in the region. Whether through free trade agreements (concluded with Singapore and being pursued with Korea, Malaysia, and Thailand), bilateral WTO accession agreements (Vietnam, Cambodia and Laos), or other trade-enhancing arrangements, USTR is working actively to strengthen and deepen U.S. trade relations in East Asia. These efforts will ensure that we maintain durable and balanced ties in the region as a whole, to the benefit of those countries and the United States.

Multilateral Engagement

Multilaterally, China can strengthen the WTO by opening its markets beyond the specific requirements of its accession agreements, and by playing a more active and positive role in the Doha Round negotiations, which are at a critical juncture. China has gained a lot from its membership and participation in the international trading system, and it stands to lose much if that system is weakened or atrophies. As it takes its place as one of the larger WTO members, China should be expected to provide leadership in advancing the rules-based system and a global framework for fair and free trade in the context of the WTO. At the most basic level, that means advancing meaningful offers and requests in the WTO negotiations, especially in the areas of agriculture and services. It also means fully embracing and complying with the letter and spirit of the obligations it has already undertaken.

Enforcement

The Administration will not hesitate, when appropriate, to use all tools at its disposal to ensure that China lives up to its commitments, including dispute settlement at the WTO or the use of trade remedies within our own legal system. In January of this year, we were poised to bring a case against China for its treatment of our kraft linerboard exports, when at the eleventh hour China reversed course and rescinded its improper antidumping duties. We will continue to hold China accountable. That is our responsibility to the workers, farmers and businesses here in the United States.

Utilizing these tools should not be viewed as a failure in our bilateral relationship. If our two countries have a dispute and use legal channels to resolve it, it is not a sign of an adversarial relationship but rather a sign of a mature one. Disputes between the United States and Europe, for example, have not obscured the benefits of our billion-dollar-a-day trade relationship. Rather, knowing that litigation is a real option tends to have the benefit of focusing minds on viable solutions. To give some perspective on this issue, the European Communities (EC) has been sued 63 times and the United States 86 times since the WTO entered into force in 1995. Interestingly, the United States and the EC have tracked each other closely over the years in terms of the number of cases, with the number declining for both in recent years. Since 2001, the U.S. and EU have each brought exactly 16 cases. Other WTO members have been very active as well. For example, Brazil has brought 22 WTO cases, 16 of them since 2000. In that same period, Korea has brought 10 WTO cases.

In many ways, China has been an anomaly in terms of its isolation from the WTO dispute settlement process. Despite its growing economic presence, China has been the defendant in exactly one WTO case, brought by the United States. Now that China's transition period as a new WTO member is drawing to an end, we should expect China to be more active in the dispute settlement mechanism, both as a complainant and a defendant.

We have recently announced the establishment of a China Enforcement Task Force at USTR, as promised in our "top-to-bottom" review of the U.S.-China trade relationship. The task force has already met and begun its work, and it has moving forward quickly with a broad and aggressive agenda. The task force has begun focusing on issues where there is a need to enforce China's WTO obligations through dispute settlement. But, it will also approach enforcement in a more comprehensive manner, by using WTO mechanisms short of dispute settlement more effectively, by seeking to ensure that China lives up to the bilateral commitments that it has made, for example, in the JCCT context, and by developing strategies for addressing trade problems that have so far not lent themselves to effective discipline, such as the Chinese government's excessive subsidization of a range of Chinese industries.

Conclusion

Mr. Chairman and members of the Commission, thank you for providing me with the opportunity to testify. I look forward to your questions.