CHINA AND THE WTO: ASSESSING AND ENFORCING COMPLIANCE

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Panel II: Evaluating Available Trade Remedies

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Members of the Commission, good morning. I appreciate the opportunity to again appear before the Commission as it reviews aspects of China's compliance with its WTO commitments and obligations after three years of WTO membership. My statement today addresses the effectiveness of available U.S. trade remedies vis-à-vis Chinese imports.

Introduction

Before turning to that topic, if I may, I would like to make some overall observations about China's WTO compliance. As I noted last year, China's accession to the World Trade Organization was a significant and historic event and it continues to be a great experiment. Thirty seven months have now passed since China's accession. We are now capable of greater perspective as to how successful China has been, and is likely to be, in meeting the commitments it agreed to at accession.

Recently, as an update to previous reports, my firm prepared a report for the Commission on the status of China's compliance with its WTO commitments in 2004, the third year of China's WTO membership. The report covered a variety of topics including compliance deficiencies; the use of China-specific safeguard measures in the U.S.; whether China's exchange rate policy is susceptible to a WTO challenge; the non-market economy status of China in U.S. antidumping proceedings and the prospects for change of that status; the U.S. policy of not applying countervailing duty law to China and other non-market economy countries; the problems of infringement and lack of enforcement of intellectual property rights in China; areas where a WTO challenge should be considered due to China's non-compliance with commitments; and the operation and effectiveness of the Transitional Review Mechanism.

In 2004, China met its WTO commitments in numerous areas. However, there continued to be areas of non-compliance that caused concern to the U.S. government and the U.S. private sector. A short review of the primary areas of compliance concerns in 2004 includes the following:

- Intellectual property rights: China has undertaken major efforts to revise its IPR laws and regulations but piracy remained rampant and enforcement seriously inadequate.
- Trading and distribution rights: China implemented its commitment to full trading rights ahead of schedule but concerns remain regarding distribution rights because China did not issue specific rules clarifying how distribution rights would be acquired.
- Services: In many services sectors, China met the letter of its liberalization commitments but frustrated the spirit by imposing new and burdensome licensing and operating requirements, such as high capital requirements and prudential rule requirements that exceed international norms.
- Agriculture: U.S. exporters experienced continued problems with market access and transparency.
- Industrial policies: In a number of areas, China has continued to employ policies that effectively limit or impose conditions on market access, or give preferential treatment. Some selected examples include:
  - discriminatory VAT policies
  - failure to provide national treatment with respect to price controls on medicines and drug reimbursement
  - preferential import duties to certain products (particularly from Russia)
  - discriminatory application of SPS measures
  - disparate standards testing of foreign products compared to domestic products
  - inadequate transparency for proposed technical regulations and conformity assessment procedures
  - development of unique standards for products in spite of existing international standards
  - inconsistent application of the China Compulsory Certification (CCC) mark
  - investment laws and regulations that continue to "encourage" technology transfer
  - auto industrial policy that discourages auto parts imports and encourages use of domestic technology
  - government procurement policy that mandates purchases of Chinese-produced software to the extent possible

Available Trade Remedies: Are They Effective in Dealing With Imports from China?

WTO Members agreed to the accession of China to the WTO in December 2001 before China had achieved a fully WTO-consistent trade regime. A key element in granting early accession to China was the establishment or maintenance of a number of trade remedy measures or policies that other Members could use in the event that, during China's transitional period to full WTO compliance, imports from China caused market disruption or injury to their domestic industries.

In evaluating the effectiveness of available trade remedies, this paper focuses on the two China-specific safeguard measures (*i.e.*, the product-specific safeguard, known in U.S. law as Section 421, and the China textile safeguard), and the chronic problem of under-collection of antidumping duties on Chinese imports covered by antidumping duty orders. In addition, the paper addresses one trade remedy that is not currently available with respect to Chinese imports, but could and should be available – that is, the application of countervailing duty law to Chinese imports benefiting from countervailable subsidies.

1. Section 421 Safeguard

In Article 16 of its Protocol of Accession, China agreed that, for 12 years following China's accession to the WTO (or until December 11, 2013), WTO Members could use a general "product-specific special safeguard" measure with respect to Chinese goods. This product-specific safeguard is applicable to any type of product (both industrial and agricultural goods) and permits the U.S. and other WTO Members to take action to curtail imports of Chinese goods that cause or threaten to cause "market disruption" to a domestic industry producing similar goods. The transitional product-specific safeguard is unique to China. No other acceding country (either to GATT or the WTO) has been subject to such a special product-specific safeguard.

The U.S. and other WTO Members insisted on the China-specific, product-specific safeguard mechanism because they recognized that, at accession, China still remained a long way from fully meeting all obligations of WTO membership and would require a transitional period. The product-specific safeguard provides a measure of protection for other WTO Members from import surges during China's transition to a fully WTO-consistent trade regime.

The China product-specific safeguard was enacted into U.S. law by Section 421 of the Trade Act of 1974, as amended, 19 U.S.C. § 2451. Section 421 permits U.S. domestic industries and workers adversely affected by increased imports from China to seek relief. The Clinton Administration stated, and Congress understood, that the special safeguard measure ensured that, on the lowest showing of injury, the U.S. could take effective action against import surges from China that cause market disruption in the United States.[1] In enacting Section 421, Congress indicated that the measure should be applied vigorously to address import surges from China.

1 *See U.S.-China Bilateral Trade Agreement and the Accession of China to the World Trade Organization: Hearing Before the Committee on Ways and Means, House of Representatives*, 106th Cong., 2nd Sess. 48 (Feb. 16, 2000) (statement of Charlene Barshefsky, US. Trade Representative), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=106_house_hearings&docid=f:67129.pdf.

The rationale behind Section 421 was that U.S. industries should not lose jobs due to competition from Chinese imports at a time when China was adjusting to WTO obligations. Moreover, Congress expressly stated that "if the ITC makes an affirmative determination on market disruption, there would be a presumption in favor of providing relief."[2] Further, Congress said that Section 421 established "clear standards for the application of Presidential discretion in providing relief to injured industries and workers," and that the presumption in favor of relief could be overcome "only if the President finds that providing relief would have an adverse impact on the United States economy clearly greater than the benefits of such action, or, in extraordinary cases, that such action would cause serious harm to the national security of the United States."[3]

As of January 2005, only five Section 421 investigations have occurred: (1) pedestal actuators, (2) steel wire garment hangers, (3) brake drums and rotors, (4) ductile iron waterworks fittings (DIWF), and (5) innersprings. The last active investigation was completed almost a year ago, in March 2004. Unfortunately, no Section 421 proceeding has resulted in relief to any U.S. industry. The expectations of its utility as a measure to provide relief to U.S. industries injured from a surge in Chinese imports have not been realized.

Of the five Section 421 investigations so far, the ITC made an affirmative injury determination and recommended relief in three cases and made a negative determination in two cases. No case has resulted in relief to a domestic industry, however, because the President denied relief in the three affirmative cases.

Section 421 Investigations

Product	Investigation Initiated	ITC Determination	Recommended Relief	President's Determination
Pedestal actuators	August 19, 2002	Affirmative (3-2) October 18, 2002	Quotas	Denied relief on grounds of national economic interest (January 17, 2003)
Steel wire garment hangers	November 27, 2002	Affirmative (5-0) January 27, 2003	Additional duties	Denied relief on grounds of national economic interest (April 25, 2003)
Brake drums and rotors	June 6, 2003	Negative (5-0) August 5, 2003	Not applicable	Not applicable
Ductile iron waterworks fittings (DIWF)	September 5, 2003	Affirmative (6-0) December 4, 2003	3-year tariff-rate quota	Denied relief on grounds of national economic interest (March 3, 2004)
Innersprings	January 6, 2004	Negative (6-0) March 8, 2004	Not applicable	Not applicable

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2 *See* House Report No. 106-632, 106th Cong., 2d Sess. 18 (May 24, 2000).

3 *Id.*

The last Section 421 petition was filed more than a year ago. The likely reason that there have been no new petitions in the past year is not because there has been a decrease in Chinese imports (which have continued to increase rapidly) but because U.S. industries have observed the results of the first five cases and have judged that the prospective relief to be gained from a petition is not worth the costs and time to bring it.

Moreover, it is likely that domestic parties have also been discouraged from bringing 421 petitions by the political tenor of the ultimate decision making process. In each of the affirmative 421 determinations, the Chinese government has lobbied strongly to discourage the President from granting relief. For example:

- China's Vice-Minister for Trade, Long Yongtu, came to Washington and met with Commerce Department officials in December 2002, arguing that the use of Section 421 would undermine China’s market access to the United States). *See Chinese Official Complains about China-Specific Safeguards*, ChinaTradeExtra.com, posted December 6, 2002.
- It was reported that some administration officials believed imposition of a safeguard measure on Chinese imports could have negative political consequences in that "a decision to impose the ITC remedy could lead to increased use of the China-specific safeguard, which could further complicate the bilateral trade relationship." *See U.S. Holds Door Open to Settlement in First China-Specific Safeguard Case*, Inside US-China Trade, November 13, 2002.
- “Officials from China’s Ministry of Commerce met this week with officials in the U.S. Trade Representative’s Office in an effort to convince them to reject recommendations from the International Trade Commission that the U.S. impose a tariff, a quota or a combination of both in order to limit imports of Chinese ductile iron waterworks fittings (DIWF). Informed sources said MOFCOM officials would meet with USTR yesterday (Jan. 13), and said the MOFCOM delegation consisted of officials from its Bureau of Fair Trade.” *See Chinese Officials Meet in U.S. to Argue Against 421, Furniture AD Case*, Inside US-China Trade, January 14, 2004.

The one constant uncertainty in the Section 421 process is the element of discretion granted to the President as the ultimate decision maker regarding relief. Thus, three years into China’s WTO membership, although there have been three cases in which the ITC found that a domestic industry was injured by a surge of Chinese imports and deemed relief to be warranted, no relief has been yet granted because the President exercised his discretion to reject relief.

In order to make Section 421 more available to and effective for domestic parties, there are several possible avenues:

- Congress could consider amending the statute to provide monetary relief (at least to the extent of covering legal costs) to those U.S. industries that bring a 421 petition, receive an affirmative determination and a recommendation for relief from the ITC but are then denied relief by the President. At a minimum, this small measure of compensation would assist U.S. industries (particularly those comprised of small and medium-sized companies) to recover their costs when the elements of a Section 421 case have been demonstrated.

- Congress could amend the statute to provide that any relief proposed by the USITC would be mandatory as long as consistent with WTO durational limits.
- Administratively, the USITC itself appears to have burdened the process by adding obligations on domestic petitioning industries that are not contained in the statute and which appear to misapprehend the purpose of Section 421. For example, the ITC requires domestic industries to supply adjustment plans similar to a normal Section 201 safeguard action even though the premise of the statute is implementing rights under the accession protocol to deal with the transitional period when China is undergoing further significant legal and economic reform. Bringing USITC practice into conformity with the underlying purpose and intent of the statute would not require legislative activity but possibly Congressional oversight.

2. __Textile Safeguard__

The special China textile safeguard is authorized by paragraph 242 of the Working Party Report to China's WTO accession.[4] Under that provision, if a WTO Member believes (and can show) that imports of certain Chinese textile and apparel products are "threatening to impede orderly development of trade in these products" due to "market disruption," the WTO Member can, following prescribed procedures, impose a safeguard measure restraining imports of such products. When the safeguard is imposed, China has agreed that it will restrain exports of the covered product to no more than 7.5% above the amount entered during the first 12 months of the most recent 14 months preceding the safeguard. A special textile safeguard may be imposed for up to one year, with reapplication possible. The special textile safeguard provision, itself, expires on December 31, 2008.

In the United States, the textile safeguard was not implemented by statute. Rather, the Committee to Implement Textile Agreements ("CITA"), the official U.S. government entity responsible for administering the *Agreement on Textiles and Clothing* ("ATC") implemented the textile safeguard by procedural rules issued in May 2003 which set out the procedural rules by which domestic parties could seek relief from Chinese imports by petitioning for a special safeguard action.[5]

The U.S. textile industry first attempted to use the textile safeguard mechanism in September 2002 when it filed petitions on 5 products (knit fabric; gloves; dressing gowns; brassieres; and textile luggage). These petitions were filed before CITA published procedural rules and CITA took no action on the petitions.

In May 2003, CITA issued its textile safeguard procedural rules which set out the eligibility criteria and informational and supporting data requirements for a petition. CITA also determined that the initial petitions would need to be re-filed in accordance with the procedural rules before CITA would address them.

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4 *Report of the Working Party on the Accession of China*, WT/MIN(01)/3 (10 November 2001), para. 242.

5 *See Procedures for Considering Requests from the Public for Textile and Apparel Safeguard Actions on Imports from China*, 68 Fed. Reg. 27787 (CITA, May 21, 2003).

In July 2003, the U.S. textile industry re-filed their petitions on four products: knit fabric; gloves; dressing gowns; and brassieres. In August 2003, CITA accepted three of the petitions (knit fabric, dressing gowns, and brassieres) and rejected the fourth (gloves). On December 23, 2003, CITA imposed safeguards on the three products for a one year period.

Subsequently, in June 2004, U.S. producers of socks and other textile producers filed a safeguard petition covering cotton, wool, and man-made fiber socks from China, and CITA imposed a safeguard on October 29, 2004 for a one-year period.

In October and November 2004, anticipating the expiration of global textile quotas on January 1, 2005, a U.S. textile industry coalition filed a series of new special textile safeguard petitions covering a variety of products, including cotton trousers, man-made fiber trousers, man-made fiber knit shirts, man-made fiber and cotton shirts, cotton knit shirts and blouses, cotton and man-made fiber underwear, combed cotton yarn, synthetic filament fabric, and wool trousers. What distinguished the series of new petitions was that they were based upon the "threat" of increased imports rather than upon actual increased imports. CITA accepted the new threat-based petitions but has not yet acted upon them.

Retailer and importer groups, however, claimed that CITA lacked authority to consider petitions based upon threat alone. On December 1, 2004, the U.S. Association of Importers of Textiles and Apparel filed suit in the U.S. Court of International Trade challenging CITA's acceptance of textile safeguard petitions based on the "threat" of increased imports and requested that the CIT issue a preliminary injunction enjoining CITA from granting relief. Following briefing and oral argument, on December 30, 2004, the CIT granted the motion for a preliminary injunction and issued an order enjoining CITA from proceeding on the threat-based safeguard requests during the pendency of the court action.

Subsequently, on January 25 & 27, 2005, respectively, the U.S. government appealed the CIT's preliminary injunction order to the U.S. Court of Appeals for the Federal Circuit and filed a motion to stay the preliminary injunction pending appeal, which the CIT denied on January 31, 2005.

Looking at whether the textile safeguard mechanism has been an effective trade remedy so far, the record is sparse. Since China's accession in December 2001, CITA has imposed only four textile safeguard measures, and the nine petitions filed since October 8, 2004 are now suspended as the result of a preliminary injunction issued by the Court of International Trade. Thus, a realistic assessment of the effectiveness of the textile safeguard as a remedial measure would be premature at this stage. One can say, however, that, prior to October 2004, CITA's acceptance of four of the five petitions filed preliminarily indicates that the textile safeguard is working as envisioned by the U.S. and other WTO Members.

The outcome of the present court challenge to CITA's authority to accept petitions based upon the threat of increased imports will be relevant in the short term to the ability of U.S. companies and their workers to obtain relief before a significant increase in imports occurs in fact for remaining textile products being reintegrated after expiration of the global quotas.

While the preliminary injunction may delay consideration of the merits of the threat-based petitions (which may result in the loss of both jobs and some companies), the industry and workers should be able to file petitions by the second half of 2005 if Chinese imports surge as anticipated.

3. __Under-Collection of Dumping Duties on Chinese Imports__

In U.S. law, the trade remedy of antidumping law applies to imports from China as well as to other countries. For non-market economy countries, such as China, U.S. antidumping law provides a special methodology for calculating normal value. Under the NME methodology, Chinese exporters are deemed to be operating within a centrally planned economy in which the government controls pricing and production decisions and Commerce treats all exporters as a single enterprise, except in cases where individual companies can demonstrate an absence of government control over their export activities. In applying the NME methodology, in calculating normal value, Commerce disregards prices and costs in the Chinese market and resorts instead to prices and costs in a comparable market-economy surrogate country. China's Protocol of Accession (Article 15) permits WTO Members to apply an NME methodology to Chinese imports subject to antidumping investigations for 15 years after China's WTO accession (or until December 11, 2016).

While antidumping law is an available trade remedy, in recent years, it has become apparent that, due to significant undercollection of dumping duties by U.S. Customs, particularly on Chinese products, U.S. industries that successfully petitioned for antidumping duty relief from Chinese imports have not received the full benefits of antidumping duty orders to which they are entitled under U.S. law.

In March 2004, in its FY 2003 annual report on the Continued Dumping and Subsidy Offset Act (CDSOA), the Customs and Border Protection Agency (CPB) reported that it had failed to collect $130 million of antidumping and countervailing duties, $103 million of which related to antidumping duties on Chinese imports, such as crawfish, paint brushes, iron castings, roller bearings, silicon metal, brake rotors, garlic and honey.

The reasons for the undercollection of duties are multiple and complex. Among the contributing causes are: (1) failure by importers to post adequate cash deposits or bonds on entries, (2) failure by CBP to require a single entry bond on entries and instead allowing importers to post a continuous entry bond, (3) allowing importers to post continuous entry bonds that are too low to cover eventual dumping liability, (4) cash deposits that are posted on estimated duties are lower than finally-determined duties but the importer fails to pay the difference due to bankruptcy or disappearance, and (5) in the case of "new shipper" reviews, a "loophole" that allows importers to post a bond on estimated dumping duties rather than cash deposits.

In repeated cases, importers have failed to pay the full amount of duties owed and when CPB attempted to collect on the bonds or the duties owed in excess of cash deposits, the bonds were not sufficient to pay in full the amount of duties owed and CBP was unable to collect the additional duties owed due to the bankruptcy or disappearance of importers. It also appears that some Chinese companies have set up shell companies as a means to use the “new shipper” loophole. Senators Byrd and Cochran described the “new shipper” problem as follows:

> Under current U.S. trade law, some exporters are exploiting a loophole in the "new shipper" "provision to undercut AD/CVD orders that are designed to protect U.S. agricultural and industrial industries from dumped and unfairly subsidized imports. U.S. law gives importers of goods exported by new shippers the privilege of posting either a cash deposit or a bond as security for the amount of duties that CBP may ultimately assess against the imports. Unfortunately, many "new shipper" importers are using the bonding privilege to evade the payment of *any* duties. If the U.S. government determines that duties must be paid, the importer can evade payment by defaulting or dissolving the company. CBP has had particular problems collecting duties on imports from new shippers in China. In fact, in FY 2003, CBP was unable to collect $130 million in import duties, including over $100 million in uncollected duties relating solely to imports from China.[6]

In response to Congressional criticism, CBP proposed a series of reforms, including working with the Treasury Department to ensure that surety bond companies can cover defaults, enforcing the requirement to post single entry bonds for each entry of goods subject to antidumping duties, and closely monitoring continuous entry bonds that U.S. importers must obtain to cover antidumping duties. In addition, Commerce increasingly has required new shippers to post bonds at the higher “all others” rate rather than a zero rate.

Separately, to address the “new shipper” undercollection problem, Senators Byrd and Cochran proposed legislation that would delete the provision in U.S. law that allows importers of products from “new shippers” to post bonds to cover estimated dumping duties, which would ensure that all imports from new shippers would be secured by cash deposits, the normal practice in administrative reviews. Although the Byrd-Cochran bill passed the Senate in the 108th Congress, the legislation failed to get House approval.

Despite CBP’s efforts to improve antidumping duty collection, the CBP’s FY 2004 CDSOA Report showed an even larger gap in duty collection in 2004 compared to 2003. CPB reported in early January 2005 that, in FY 2004, it failed to collect $260 million in antidumping and countervailing duties, $224 million of which related to antidumping duties owed on Chinese imports.

Because of the annual report, the magnitude of the undercollection problem has been identified. It is clear that the bulk of the undercollection problem stems from Chinese product imports. Indeed, the 60 antidumping duty orders on Chinese products represent only 17 percent of all U.S. AD and CVD orders but 85 percent of the duty undercollection problem. It is critical that the

[6] Letter to Senate Colleagues from Senators Byrd and Cochran, May 14, 2004.

full amount of duties owed be collected. Action by Congress, CBP, and Commerce are desperately needed to ensure the proper functioning of U.S. law.

4. Non-Application of Countervailing Duty Law to Imports from China

It is the present policy of the U.S. Commerce Department that countervailing duty law is not applicable to non-market economy countries. Because the U.S. considers China to be a non-market economy country, the Commerce Department views U.S. countervailing duty law as not applicable to China. In consequence of this policy, U.S. industries cannot petition for the imposition of countervailing duties when they are injured by reason of Chinese imports benefiting from government subsidies.

The U.S. first stated its current policy in 1984 in two antidumping proceeding involving steel wire rod from Czechoslovakia and Poland, both non-market economy (NME) countries at the time. Commerce's NME classification was founded on an economic analysis that concluded that “markets” did not exist in countries that relied on government central planning to allocate resources and prices. Commerce therefore determined that CVD law is not applicable to exports from an NME country because subsidization is a market economy phenomenon and cannot exist in an NME where “markets” do not exist. The U.S. Court of Appeals for the Federal Circuit found that Commerce’s determination was not unreasonable and therefore affirmed.

At present, the trade remedy of CVD law is not available to address problems caused by Chinese subsidies. The current U.S. position, however, is not required by the statute. Rather, it was established by an administrative determination (affirmed in court litigation) and could be reversed or changed by administrative action. Indeed, the U.S. position is bizarre at the present time in light of the heavy emphasis the U.S. placed on eliminating or limiting subsidies as part of China’s accession process to the WTO. If subsidies in modern day China don’t distort markets, why did the U.S. insist time and time again that such subsidies had to be eliminated, reduced, identified and/or reported? Moreover, in the most recent Transitional Review Mechanism, the U.S. identified a large number of Chinese subsidy programs that appeared to constitute either prohibited or actionable subsidies under the WTO Agreement on Subsidies and Countervailing Measures.[7]

The U.S. policy could be changed in two ways. First, Congress could amend the countervailing duty law to expressly provide that CVD law applies to non-market economy countries. In the 108th Congress, bills were introduced in both the House and Senate to make such a change. Second, Commerce could change its present policy on its own (which it has the discretion to do). Given that Commerce's policy is not required by statute, a change in policy would likely be upheld by the courts as long as Commerce supports the change with reasoned analysis.

Thank you for the opportunity to appear today. I would be pleased to respond to any questions.

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7 *See Request from the United States to China Pursuant to Article 25.8 of the Agreement on Subsidies and Countervailing Measures*, G/SCM/Q2/CHN/9 (6 October 2004).