

# **China in the WTO**

Testimony of

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***Evaluating China's Role in the World Trade  
Organization Over the Past Decade***

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The relationship of the commerce of nations to their power is a vitally important one. In the case of the relative positions of the United States and China, this Commission, by its mandate, is perhaps the best body in this country to address this subject. Much that is valid and important has been written about how closely fiscal deficits of countries are aligned with their standing in world affairs<sup>1</sup>. Often neglected in these analyses is the position of countries in trade and impact of trade on the composition of their economies. What a country is able to produce is central to its national well-being and to its prospects. Building on the economist David Ricardo's example of England and Portugal being better off for specializing respectively in textiles and wine, and to engage in trade to their mutual benefit, it should now be recognized that it would matter in terms of the eventual world role each of these countries was ultimately able to play which of them produced the more advanced good and which did not.

When China trades with Chile, it matters which is supplying the copper ore and which the manufactured goods, although each may be prospering from their mutual trade. The stakes are respectively much higher for the current leading world power and the most rapidly emerging world power. If China limits its exports of rare earths and imports of fiber optics, and limits its purchasing of wind turbines produced by foreign firms, that is worth the attention of U.S. policy makers, as China is, in seeking to shape its own economy, shaping our economy and those of others as well. It is in this context of the real impact of trade policies that China's performance in the World Trade Organization must be assessed.

The lead article in the most recent issue of Foreign Affairs and a prominent piece recently in the New York Times describe China's building a blue-water navy to protect the sea lanes which carry its commerce. Here China is thinking not of the trade that is most written about in the United States and elsewhere, China's massive and expanding exports, but rather China's imports – of oil and raw materials. Outside of export controls, considerations of national security play very little role in the crafting of U.S. trade and domestic economic policies. For its part, China's leaders think in terms of national security when they consider the size and composition of China's economy. They are concerned about maintaining growth not only for increasing the standard of living of the Chinese people but for the resulting domestic social stability. The U.S. government is, of course, also concerned with the welfare of its citizens. President Obama has set as a national goal the doubling of exports within five years, driven in large part by a need to reduce unemployment, but also to reduce international monetary imbalances that threaten the financial well-being of the country. In the President's National Security Strategy, delivered to the Congress on May 27, 2010, there is recognition of the relationship of the strength of the economy to national security:

***Renewing American Leadership—Building at Home, Shaping Abroad***

*Our approach begins with a commitment to build a stronger foundation for American leadership, because what takes place within our borders will determine our strength and influence beyond them. . . .*

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<sup>1</sup> Niall Fergusson among the best.

*At the center of our efforts is a commitment to renew our economy, which serves as the wellspring of American power.*

Besides being for open markets worldwide and supporting renewable energy development at home, United States government policy-makers do not generally think of trade and the composition of the U.S. economy in terms of national security.

When it comes to policy measures to meet national commercial goals, the similarities between the China and the United States are few. This is partially due to the differing natures of the two countries' economies and their respective modes of government. On a spectrum of degree of government intervention in the economy, China would be nearer to the state-developmental capitalism end of the spectrum and the United States would be closer to the free market end, with the added element that our government is specifically designed to be limited by a series of checks and balances. China is better known at present for vast national projects. In the course of American history, the United States has mobilized national resources behind industrial goals, most notably as a result of external challenges.

Examples of America's national mobilizations of resources are to be found in FDR's "Arsenal of Democracy" speech in late December 1940, the American response to the Soviet Union's launch of Sputnik in October, 1957, and President Kennedy's announcement of the lunar manned space flight. And the U.S. government has also supported development of the transistor, the internet, global positioning system technology, aluminum (for WWII), and titanium (for the Korean War). It spends a large amount on health-related research. The EU has claimed that the United States has unfairly supported commercial aircraft through military procurement. However, the role of the U.S. government in creating and maintaining the industrial base is nevertheless comparatively limited, especially when compared with the current industrial policy environment in China. On average, for its industrial base, United States government support is not a major factor for most industries. In this respect China differs. The extent of its promotional policies for industry is a much greater. It is a multiple of that found in Europe (with the prominent exception of airbus) or the United States<sup>2</sup>.

China has had an unrelenting national goal of economic growth since Deng Xiaoping began the process of opening China to market forces through foreign investment in 1978. This policy of opening China was in effect continued through China's accession to the WTO in 2001. China's joining the WTO brought it two signal benefits – continued reform of the Chinese economy to increase the international competitiveness of its domestic industries and an assurance of continued largely unfettered access to foreign markets for its exports.

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<sup>2</sup> There are numerous examples of U.S. successes in "industrial policy", including creation of a world-class agriculture sector through the Homestead Act, land grant colleges, and numerous other measures in the 19<sup>th</sup> and 20<sup>th</sup> Centuries. The point made above is still valid. The impact of WTO rules on a country like that of China will differ from the impact of these policies on a country like the United States.

It is in this context that I will address the seven specific questions this Commission sent out for comment<sup>3</sup>, with the understanding that you also have accorded your witnesses the freedom to address other issues that they believe to be important.

### ***U.S. Goals in Having China Join the WTO – Was This a Good Policy?***

To begin with, I will combine my answers to three of the Commission's questions that focus on U.S. policies:

***Why in your view did the U.S. government support China's entry into the WTO?***

***What were the major political and economic goals that the United States hoped to achieve? Have we achieved those goals?***

***Would the U.S. have been better off by not letting China into the WTO but instead using Section 301 to ensure China's compliance with fair and free trade practices?***

Since the Second World War, the United States has led the way in creating a world trading system based on the rule of law and movement toward a global regime for trade in which market forces would determine competitive outcomes. In 2001, the year China joined the WTO, China already ranked within the top ten of the world's exporters and importers<sup>4</sup>. Forcing China to remain outside the WTO would have been antithetical to this vision. The United States already accorded China most-favored-nation treatment as a result of a bilateral agreement.<sup>5</sup> It is true that the United States would have been free

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1. *Why in your view did the U.S. government support China's entry into the WTO?*
  2. *What were the major political and economic goals that the United States hoped to achieve? Have we achieved those goals?*
  3. *What did China hope to achieve by joining the WTO? Has China achieved it goals?*
  4. *Has China's entry into the WTO had a positive or negative impact on the economy and national security interests of the United States?*
  5. *How has China's admission to the WTO changed that organization and how has China's admission affected that nation's relationship with the United States?*
  6. *Has the United States been able to satisfactorily challenge China's non-compliance under the WTO dispute settlement process?*
  7. *Would the U.S. have been better off by not letting China into the WTO but instead using Section 301 to ensure China's compliance with fair and free trade practices?*

<sup>4</sup> In 2000, China was the 7th leading exporter and 8th largest importer of merchandise trade - exports: 249.2 billion dollars (3.9% world share), imports: 225.1 billion dollars (3.4% world share). For commercial services China was the 12th leading exporter and the 10th largest importer - exports: 29.7 billion dollars (2.1% share), imports: 34.8 billion dollars (2.5% share). Press/243, 17 September 2001, "WTO successfully concludes negotiations on China's entry".

<sup>5</sup> Agreement On Trade Relations Between The United States Of America And The People's Republic Of China, July 7, 1979. In effect, the bilateral trade agreement accorded only conditional MFN contingent on review by the Congress. That review became more controversial with the advent of the 1989 Tiananmen Square and human rights issues coming to the fore. It is possible that without legislative approval of Permanent Normal Trade Relations, China's accession to the WTO could have resulted in U.S. "non-application" of the WTO to China.

to terminate that agreement and, had China not become a WTO member, would not have had the application of U.S. trade remedies regulated by binding dispute settlement. It is also true that China's trade commitments under the WTO agreements are far broader than the coverage of any bilateral trade agreement could have achieved.

The United States believed that bringing China into the WTO would foster domestic economic reforms within China, which would ultimately create a functioning large and growing market for U.S. goods and services. As the America's top trade negotiator said at the time:

*China's WTO accession is a clear economic win for the United States. Together with permanent NTR (Normal Trade Relations), it will open the world's largest nation to our goods, farm products and services in a way we have not seen in the modern era.*

U.S. Trade Representative Charlene Barshefsky, February 2000.

Large U.S. headquartered multinational businesses shared this vision. They saw China as a major market and a major source of supply for all other markets including the United States. They also foresaw that a China that was within the WTO would be a more stable place for investment, both to serve the Chinese market and as an export platform<sup>6</sup>.

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. In addition, there was an untested American theory that the more free the play of market forces, the more likely that there would be progress in China toward democracy -- a goal the United States promotes wherever it can. It is a hope that economic liberalization would bring with it political liberalization.<sup>7</sup> President Bush said in a statement not dissimilar from Clinton Administration statements:

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<sup>6</sup> *Even before the first vote was cast yesterday in Congress's decision to permanently normalize U.S. trade with China, Corporate America was making plans to revolutionize the way it does business on the mainland. And while 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." The Wall Street Journal, 25 May 2000, Opening Doors: Congress's Vote Primes U.S. Firms to Boost Investments in China --- Debate Focused on Exports, But for Many Companies, Going Local Is the Goal --- 'Looking for Predictability'*

<sup>7</sup> *China's accession to the WTO will help break the state monopoly of wealth and hence its power. Getting resources into the hands of the Chinese citizenry is the best way for them to articulate demands and press for reform over the long-term. Former Tiananmen dissident Dai Qing and Hong Kong's leading pro-democracy legislator, Martin Lee, both argue that PNTR passage will help promote the rule of law in China-a prerequisite for both economic and political reform. It is also noteworthy that Taiwan's newly elected president, Chen Shui-bian, is in favor of PNTR passage. To not do so, he argues, will only play into the hands of those in Beijing who wish to take Taiwan by force and see the United States as a military*

*I am confident that China's entry into the WTO will bring other benefits to China beyond the expected economic benefits. WTO membership, for example, will require China to strengthen the rule of law and introduce certain civil reforms, such as the publication of rules. In the long run, an open, rules-based Chinese economy will be an important underpinning for Chinese democratic reform.*<sup>8</sup>

In gauging the value of what the United States and the other WTO members received as part of China's joining the WTO, it is worth recalling the entry price for its accession. It is probably safe to conclude that no country has made as many changes to its laws and regulations and to its economy as China committed to do, and in very many cases did do, in order to join the World Trade Organization<sup>9</sup>. Thousands of measures were amended to comply with WTO requirements and with the commitments China made in the course of the accession negotiations. This required not a gradual shift toward accommodation to the rules of the WTO, but in most cases adherence either immediately or after a relatively short delay. China started from a position well behind that of the other BRIC countries and easily exceeded their commitments; and, in no small measure, as a result of the liberalization China's commitments entailed, exceeded their economic performance, as well.<sup>10</sup>

The following are highlights of the specific commitments that China made in the Working Party on its Accession to the WTO. It is an impressive list. China:

- Bound its tariffs on simple (non-trade-weighted average to 10% (agriculture at 15.8%, non-agriculture at 9.1%). This compares with Brazil, which has bound

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*threat.* A Vote for PNTR is a Vote for the U.S. Economy and Chinese Reform, by Mark A. Groombridge, Cato.

*Extending PNTR to China will enhance our national security by ensuring that in the new century, China will be on the inside of the international system, playing by global rules, instead of on the outside, denying them. Furthermore, as China becomes a stakeholder in the WTO and other international regimes, it will be more likely to accept the legitimacy of international norms, and define its future within the international community, not outside of it.* China, PNTR and National Security, DLC Talking Points, May 7, 1998.

<sup>8</sup> "President Welcomes China, Taiwan into WTO, Statement by the President: Ministerial Decision to Admit the People's Republic of China and Taiwan Into the World Trade Organization," White House Press Release, 11 November 2001, <<http://www.whitehouse.gov/news/releases/2001/11/20011111-1.html>> (17 June 2002).

<sup>9</sup> In comparison, by and large, the GATT was constructed to mirror U.S. domestic law rather than requiring its wholesale reform, but the U.S. still had to liberalize with respect to imports into its own market through successive rounds of multilateral trade negotiations.

<sup>10</sup> Implicit in the GATT and its successor, the WTO, is that the rules are being applied to a market economy, although there is nothing explicit in the Agreements that require this as a condition of membership. It became obvious with nonmarket economies that something more was needed, and import targets were set for some of the earlier accessions on NMEs. With China, the approach taken was to negotiate very elaborate and pervasive commitments that were incorporated in the Working Party Report that accompanied the accession. The commitments made by China in the Working Party Report have been found by a WTO panel to be binding on China.

rates at 31.4% (agriculture at 35.5% and non-ag at 30.8).and India at 49% (agriculture at 114.2% and non-ag at 34.7%);<sup>11</sup>

- In agriculture, committed not to apply any export subsidy upon its accession;<sup>12</sup>
- Pledged that it would provide national treatment for import certification and testing;
- Committed to establish a modern commercial banking system;
- Would not require foreign exchange balancing of imports and exports by any enterprise;
- Committed that its investment guidelines and their implementation would be in full conformity with the WTO Agreement;
- Confirmed that it would ensure that all state-owned and state-invested enterprises would make purchases and sales based solely on commercial considerations, e.g. price, quality, marketability and availability, and that the enterprises of other WTO Members would have an adequate opportunity to compete for sales to and purchases from these enterprises on non-discriminatory terms and conditions; in addition, the Government of China would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, including on the quantity, value or country of origin of any goods purchased or sold, except in a manner consistent with the WTO Agreement;
- Confirmed that, without prejudice to its rights in future negotiations in the Government Procurement Agreement, all laws, regulations and measures relating to the procurement by state-owned and state-invested enterprises of goods and services for commercial sale, production of goods or supply of services for commercial sale, or for non-governmental purposes would not be considered to be laws, regulations and measures relating to government procurement;
- Confirmed that it would from the date of its accession only impose, apply or enforce laws, regulations or measures relating to the transfer of technology, production processes, or other proprietary knowledge to an individual or enterprise in its territory that were not inconsistent with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS Agreement") and the Agreement on Trade-Related Investment Measures ("TRIMs Agreement");
- Confirmed that price controls would not be used for purposes of affording protection to domestic industries or services providers;

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<sup>11</sup> Source: WTO statistical tables on the WTO website. The WTO website shows the U.S. having a average total tariff of 3.5%, 4.8% for agricultural products, and 3.3% for non-agricultural products.

<sup>12</sup> [http://www.wto.org/english/news\\_e/pres01\\_e/pr243\\_e.htm](http://www.wto.org/english/news_e/pres01_e/pr243_e.htm)

- Confirmed that administrative regulations, departmental rules and other central government measures would be promulgated in a timely manner so that its commitments would be fully implemented within the relevant time frames;
- Confirmed that it would in a timely manner annul local regulations, government rules and other local measures that were inconsistent with its obligations;
- Confirmed that it would revise its relevant laws and regulations so that its procedures for judicial review of administrative actions would be consistent with the requirements of the WTO Agreements, and that the tribunals responsible for such reviews would be impartial and independent of the agency entrusted with administrative enforcement, and would not have any substantial interest in the outcome of the matter;
- Confirmed that within three years after accession, all enterprises within China would be granted the right to trade;
- Confirmed that upon accession it would participate in the Information Technology Agreement ("ITA") and would eliminate tariffs on all information technology products as set out in its schedule; and eliminate all other duties and charges for ITA products;
- Confirmed that from the date of accession, it would ensure that its laws, regulations and other measures relating to internal taxes and charges levied on imports would be in full conformity with its WTO obligations and that it would implement such laws, regulations and other measures in full conformity with those obligations;
- Confirmed that the administration of quotas and import licenses, and tariff-rate quotas would be nondiscriminatory, and that allocation would be transparent;
- Confirmed that, upon accession, it would apply fully the Customs Valuation Agreement;
- Confirmed that it would abide by WTO rules in respect of non-automatic export licensing and export restrictions;
- Confirmed that it would eliminate all export subsidies and all subsidies contingent upon the use of domestic over imported goods;
- Stated that it would progressively work towards a full notification of subsidies;
- Stated that it would open up for public comment its standards-making procedures and increasingly base its standards on international standards;



- Confirmed that it would fully comply with the Sanitary and Phytosanitary (SPS) Agreement and would ensure the conformity with the Agreement of all of its laws, regulations, decrees, requirements and procedures relating to SPS measures;
- Stated that all measures applicable to motor vehicle producers restricting the categories, types or models of vehicle permitted for production, would be completely removed two years after accession, thus ensuring that motor vehicle producers would be free to choose the categories, types and models they produced;
- With respect to agricultural imports, it would not maintain, resort or revert to guidance plans or administrative guidance at the national or sub-national level that regulate the quantity, quality or treatment of imports, or constitute import substitution practices or other non-tariff measures, including those maintained through state trading enterprises at the national or sub-national level;
- Noting the advanced state of protection for intellectual property rights in China, confirmed that upon accession it would fully apply the provisions of the TRIPS Agreement, rather than phase in its adherence to the Agreement;
- Committed to permit internal branching for insurance firms consistent with the phase-out of geographic restrictions;
- With respect to its Schedule of Specific Services Commitments, confirmed that, while it had limited its market access commitments in some sectors to permit foreigners to hold only a minority equity interest, a minority shareholder could enforce rights in the investment under its laws, regulations and measures; and moreover, WTO Members would have recourse to WTO dispute settlement to ensure implementation of all commitments in its GATS schedule;
- Confirmed that it would make available to WTO Members translations into one or more of the official languages of the WTO all laws, regulations and other measures pertaining to or affecting trade in goods, services, TRIPS or the control of foreign exchange, and to the maximum extent possible would make these laws, regulations and other measures available before they were implemented or enforced, but in no case later than 90 days after they were implemented or enforced; and
- Stated that it intended to become a Party to the Government Procurement Agreement (GPA) and that until such time, all government entities at the central and sub-national level, as well as any of its public entities other than those engaged in exclusively commercial activities, would conduct their procurement in a transparent manner, and provide all foreign suppliers with equal opportunity to participate in that procurement pursuant to the principle of MFN treatment, i.e., if a procurement was opened to foreign suppliers, all foreign suppliers would be

provided with equal opportunity to participate in that procurement (e.g., through the bidding process).

This is not a complete list of China's commitments contained in the Accession Working Party Report -- nor does it reflect all of the other pledges China made that are contained in the Protocol of Accession and the WTO Agreements to which China acceded. But it does give a reasonable picture of the breadth and scope of commitments made specifically by China in the process of negotiating its accession to the WTO.

In reviewing the list, a variety of thoughts come to mind. Some requirements immediately jump out as not having been met – China is still “negotiating” to join the Government Procurement Agreement nine years after it committed to become a signatory. Some were delivered on immediately – tariff bindings for example. Others are currently complied with to an increasing extent. In still other cases, performance is eroding further against the benchmarks laid down in 2001.

To accomplish all of the list at one instant in time would have been truly heroic, and one has to believe that some of the pledges, solemn as they were, had to be somewhat aspirational as opposed to being capable of immediate fulfillment. In some cases, perhaps they represented overreaching by China's trading partners, violating the first maxim of seasoned negotiators – never negotiate for more than the other side can deliver. And one could forgive a lot in terms of a shortfall from expected performance -- were it not for China's size and its importance in the international trading system. China's share of world trade in goods was 4.3% in 2001, and was expected to continue to rise quickly.<sup>13</sup> In fact, the countries participating in China's accession negotiation took China's commitments very seriously and there are many statements and actions indicating that to a large degree China did so as well.

Any review of China's WTO accession must also take note of China's agreeing to accept some instances of legalized discrimination with respect to its exports. China agreed for a period of twelve years to let other countries take otherwise WTO-inconsistent safeguard measures against its exports under a Transitional Product-Specific Safeguard Mechanism. This provision, contained in the Protocol of Accession, states that

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<sup>13</sup> "In share terms, China's international goods trade advance has been equally dramatic, rising from only 1.8 percent of world goods exports in 1980 to 4.3 percent in 2001". [http://www.uscc.gov/researchpapers/2000\\_2003/reports/03\\_oct\\_drallenlenz.htm](http://www.uscc.gov/researchpapers/2000_2003/reports/03_oct_drallenlenz.htm). "In 2000 China was the 7th leading exporter and 8th largest importer of merchandise trade - exports: 249.2 billion dollars (3.9% share), imports: 225.1 billion dollars (3.4% share). For commercial services China was the 12th leading exporter and the 10th largest importer - exports: 29.7 billion dollars (2.1% share), imports: 34.8 billion dollars (2.5% share)." [http://www.wto.org/english/news\\_e/pres01\\_e/pr243\\_e.htm](http://www.wto.org/english/news_e/pres01_e/pr243_e.htm). "China's exports this year have already vaulted it past Germany to become the world's biggest exporter." New York Times, Oct. 13, 2009. According to the WTO, China accounted for 8.9% of world exports in 2008 and 5.9% of world imports. The comparable figures for the United States were 8% and 13.15%, respectively. China's current account surplus, according to the IMF, has averaged US\$ 335 billion/year for the period 2006-2009.

*In cases where products of Chinese origin are being imported into the territory of any WTO Member in such increased quantities or under such conditions as to cause or threaten to cause market disruption to the domestic producers of like or directly competitive products, the WTO Member so affected may request consultations with China with a view to seeking a mutually satisfactory solution, including whether the affected WTO Member should pursue application of a measure under the Agreement on Safeguards.*

*If, in the course of these bilateral consultations, it is agreed that imports of Chinese origin are such a cause and that action is necessary, China shall take such action as to prevent or remedy the market disruption.*

*If consultations do not lead to an agreement between China and the WTO Member concerned within 60 days of the receipt of a request for consultations, the WTO Member affected shall be free, in respect of such products, to withdraw concessions or otherwise to limit imports only to the extent necessary to prevent or remedy such market disruption.<sup>14</sup>*

Paragraph 242 of the Working Party Report contains a special textile safeguard which allowed<sup>15</sup> an importing WTO member to impose quotas on Chinese textiles. In addition, China agreed to nonmarket economy treatment with respect to antidumping measures for a period not to exceed 15 years after accession, allowing data from surrogate countries to be used to assess costs of production rather than relying on costs of inputs within China.<sup>16</sup>

These are other extraordinary aspects of the extraordinary integration of China into the world's system of trading rules. The reforms China enacted were not confined to those negotiated as part of accession. While it was not required to do so by the WTO rules, China adopted an Antimonopoly Law which on its face is designed to assure that market forces, and not restrictive business practices, determine competitive outcomes<sup>17</sup>.

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<sup>14</sup> If a measure is taken as a result of a relative increase in the level of imports, China has the right to suspend the application of substantially equivalent concessions or obligations under the GATT 1994 to the trade of the WTO Member applying the measure if the measure remains in effect more than two years. However, if a measure is taken as a result of an absolute increase in imports, China has a right to suspend the application of substantially equivalent concessions or obligations under the GATT 1994 to the trade of the WTO Member applying the measure, only if the measure remains in effect more than three years.

In critical circumstances, where delay would cause damage which it would be difficult to repair, the WTO Member so affected may take a provisional safeguard measure pursuant to a preliminary determination that imports have caused or threatened to cause market disruption which measure may not remain in place for more than 200 days.

<sup>15</sup> Through December 31, 2008.

<sup>16</sup> Use of "constructed values" rather than Chinese costs is generally believed in most cases to increase the duties antidumping duties imposed on the Chinese goods. The extent to which market forces provide a valid cost or price within China will vary from case to case and will not easily be the subject of agreement. The use of "nonmarket methodology (NME)" has become a political issue, with proponents and opponents expressing strong sentiments about its appropriateness or lack thereof.

<sup>17</sup> In at least one instance, the application of the law did not seem to serve this ideal: the blocking of Coca Cola's attempted acquisition of Huiyuan Juice Ltd.

Putting aside the imbalance in bilateral trade (which the most fervent boosters of China trade are wont to do), United States exports to China certainly rose after China's WTO accession (\$16.3 billion in 2000 increasing to \$69.6 billion in 2009<sup>18</sup>). As for greater freedom within China driven by market forces, there have been some improvements in civil society. While there is no easy way of tying this to trade liberalization, the individual's freedom to pursue economic objectives may well lend itself to some progress in political liberty. (The contrary proposition -- namely that the satisfaction gained through greater material well-being could substitute for an increase in political freedom -- can perhaps be argued with equal justification.)

As noted, the United States also had foreign policy reasons for supporting China's entry into the WTO. China was clearly a growing power, at least on a regional basis as well as on the world scene. Its WTO entry would further America's interests in improving relations with China.

*[China] has become deeply engaged in the international community--but will it make a broad commitment to play by the rules and do its part to address global challenges like the spread of weapons of mass destruction and climate change? It is growing stronger but will it use that strength to build a more secure Asia, or to threaten the freedom and security of its neighbors? Ultimately, the answers will come from China. But we have an enormous stake in encouraging it to choose the path of integration and reform, not confrontation and decline. Bringing China into the WTO will make a big difference. Samuel R. Berger, National Security Advisor, at the Woodrow Wilson International Center, February 2, 2000.<sup>i</sup>*

What was the foreign policy alternative? To deal with China bilaterally? Or not to deal with China at all? Why would the U.S. have been better off with a China that was isolated (assuming the United States could have persuaded other trading countries to follow its lead in isolating China)? Would trying to turn China into a North Korea, only one that was vastly larger and more powerful, have served U.S. foreign policy interests? Not likely. The only alternative would have been to continue negotiating its WTO accession over an extended period, as has happened in the case of Russia. It is not clear what ultimate purpose deferring China's accession for an indefinite period would have served.

In terms of managing its economic relations with China, the United States would not have been better off with China outside the WTO. Section 301 would have been available in theory, but in practice there is a limit to the number of times that trade retaliation can be employed without destroying bilateral relations. In the post WWII era, the only truly unilateral uses of section 301 were provoked by the violation by Japan of a bilateral agreement to allow market access for foreign semiconductors and a continuing violation of intellectual property rights by Ukraine. It was the United States acting unilaterally and threatening to do so in other cases that caused other nations to seek binding dispute settlement as part of the world trading rules, and for the first Bush

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<sup>18</sup> The trade U.S. trade deficit with China increased from \$83.7 billion in 2000 to \$226.9 billion in 2009, down from a peak of \$263 billion a year earlier. Source: U.S. China Business Council website.

Administration (both USTR and the State Department) to accept it<sup>19</sup>. This effectively repealed section 301 vis-à-vis WTO members. Moreover, the use of trade sanctions is somewhat overrated as a means of changing a sovereign nation's conduct. The application of effective trade sanctions is a long hard process that has been the subject of a substantial amount of academic study. Sanctions imposed by one country and not multilateral are in the usual case not very likely to be effective very often. Reliance on unilateral measures threatened or imposed under section 301 rather than the employment of the WTO rules, however unsatisfactory they may be, was not a good option for the United States. Whether this remains the case, will depend on future circumstances.

***How has China's admission to WTO changed that organization and how has China's admission affected that nation's relationship with the United States?***

On the surface, China's participation in the WTO has absorbed a substantial amount of the time of that organization. China is and has been a defendant and respondent in a sizable number of dispute settlement proceedings and China's implementation of its WTO commitments is the subject of intensive Transitional Review Mechanism exercises in which China's accession commitments are the subject of active comment by other WTO members meeting in numerous WTO committees. In these meetings, WTO members do not appear to be reticent about citing defects in China's implementation of its commitments<sup>20</sup>. In addition, China's WTO membership figures heavily in the statistics for antidumping (and now perhaps countervailing duty) cases, but as far as the WTO is concerned the impact is little more than a discussion in the Antidumping Committee and China's adding another voice in the Rules Negotiation for limiting this trade remedy. None of this really changes the character of the WTO.

***a. Impact on the institution***

When any large country enters an international organization, especially an emerging political and economic superpower, there are effects, some of them quantifiable and some of them speculative. China is the world's largest exporter and the world's third largest importer. One would expect it to be extremely important in a world trade institution. At one level, there will be an impact on the secretariat of the organization. China is the third largest contributor to the WTO's budget, after the United States and Germany. These are not huge sums. In 2010 the U.S. contribution is 24.5m Swiss francs (CHF)<sup>21</sup>, for Germany CHF 16.8m, compared with China at CHF 12.2m, Japan CHF 9.6m and the EU 27 at about 40% of the total budget of about CHF 200m.

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<sup>19</sup> By the time that the Clinton Administration finished the Uruguay Round negotiations, this was considered a "done deal", and the USTR Mickey Kantor, although urged to take this back off the table, was unable to do so.

<sup>20</sup> Transitional Review Mechanism exercises have been a major endeavor for China and its largest trading partners. This process is now headed for their final year.

<sup>21</sup> At current exchange rates, about US\$ 22m. The reason the U.S. leads among individual member contributions is because of its very large imports of goods and exports of services, combined with substantial exports of goods and to a lesser extent imports of services.

Based on share of contributions, the PRC is under-represented, with perhaps less than ten of its nationals serving among a permanent staff of 665 (including contract staff, a total complement of about 800). There are no senior management positions filled by Chinese nationals. The United States is also under-represented, with only 29 nationals within the Secretariat. However, from either an Asian or a developing country point of view, the Secretariat is too “Western” and too “developed”. As a consequence, China, Brazil and India lead developing countries in pressing for "diversity" in staffing.

Large contributors naturally want a say in how the organization is run. As a major contributor, China is very conservative on WTO budget expenditures. Whether this has a purpose in terms of policy is obscure -- China is no more conservative than the United States on budget matters. As the Secretariat does not generally engage in policy making, which is left to the WTO members, this should all not matter. A question always exists as to whether, as geographic representation changes, the new hires “check their nationality at the door” and act in a completely neutral manner. Does the culture of the institution change as more Asian and Southern Hemisphere personnel are brought on board? The staffing of dispute settlement panels and of the Appellate Body would certainly matter if there were a shift in the current general neutrality of staff.<sup>22</sup> Would there be a difference in trade philosophy if there were a major shift of geographic representation to countries whose policies are more interventionist? These questions cannot be answered with any certainty.

One other issue that deserves mention: the Peoples Republic of China has a special issue in co-existing on occasion within the same organization with what it considers part of its territory -- Chinese Taipei. Much time has been devoted to the name by which the latter’s WTO mission and representatives to the WTO are called. This by no means prevents the WTO from functioning with respect to these two members.

### ***b. Is China a developing country?***

Developing countries are expected to assume a lesser level of obligations, to receive “special and differential treatment”. China considers itself to be a developing country (with a per capita GDP of US\$ 6600 in 2009<sup>23</sup>). The major developed countries, at a minimum, do not accept China’s view, and the other major emerging market countries are very concerned about competition from China. To date, the issue of China’s status has been finessed as no agreement is possible.

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<sup>22</sup> China holds one seat on the Appellate Body. AB Members can hear any case, regardless of whether it involves the country from which they come. On the other hand, panelists cannot come from the country that is a party or third country participant to the dispute without the prior consent of the parties to the dispute. This has only occurred once in some 150 panels. It is not unusual, however, for Secretariat staff assisting in dispute settlement cases to come from the countries litigating the dispute and there is no bar against this as long as they follow the Code of Conduct for dispute settlement proceedings, which requires neutrality, independence, autonomy, and lack of conflict of interest.

<sup>23</sup> CIA, The World Fact Book, <https://www.cia.gov/library/publications/the-world-factbook/geos/ch.html>.

### *c. Effect on the Doha Round of Trade Negotiations*

There is an effect, however, on the Doha Development Agenda round of multilateral trade negotiations, both by what China does and what it does not do. China is predisposed toward avoiding further liberalization as it has the view, not entirely unfounded, that it engaged in a phenomenal effort of liberalization to join the WTO just nine years ago, and some of its concessions have been phased in even more recently. It also is apparently reluctant to risk lowering its rate of economic growth, fearing an expansion of imports to a greater extent than coveting further expansion of its exports<sup>24</sup>.

To have the world's largest exporter not only not lead toward greater liberalization, but quietly lend support at crucial times to reinforce a deadlock, as occurred with respect to agricultural safeguards, adds further dead weight to an exercise that has little or no momentum. China is trying to straddle two positions at once: reluctant as it is to promise or deliver on further trade liberalization, it also apparently wishes to be a leader among emerging countries. In doing so it is making common cause with others in intransigence (which it sees as serving its interests). That is not helpful to getting the Round to move forward. China is playing a negative role of the kind that Japan used to play in the immediate prior major rounds of multilateral trade negotiations. However, this should be seen in context: Many WTO member countries show very little real enthusiasm for the Doha Development Agenda in any event.

Another aspect of China's WTO membership that is not a positive is that any concession that is given by another emerging country, such as Brazil or India, is seen as further benefiting Chinese exports and exposing those countries' nascent industries to more vigorous competition. China cannot be blamed for just being. This is not the issue. China's government procurement policies and those of its state-owned enterprises do not support the trade interests of others, so other countries do not see a lot of upside for exporting more to China as a result of the Doha Round. This compounds their sensitivity to becoming the recipient of more imports from China. Brazil, Chile, Argentina and others mainly export primary products to China with little value-added. These products are unlikely to face import barriers in China. Their exports of higher value-added goods, and those of others, face the nonmarket aspects of China economy, often in the form of restrictive procurement by state-owned enterprises, standards problems, and various national provincial and regional policies that favor Chinese products over imports. China's import-limiting procurement practices cannot be blamed on its WTO membership, however, just the reverse. China promised to join the Government Procurement Agreement and it is already committed to have its state-owned enterprises purchase solely on a commercial basis. It is the benefits of these commitments that have not yet been realized.

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<sup>24</sup> Of course, China's leaders may be very risk averse given the growth in population, the movement from agriculture of a large part of the population to the cities, and the resulting enormous demand for employment in nonagricultural jobs. In addition, it may not see the Round as promising much additional access for its exports.

As for management of the multilateral trade negotiations, Doha started out being managed by a “Quad” (the United States, the EU, Japan and Canada). The Quad no longer functions as the leader of the behind-the-scenes work as it did in prior times. Emerging countries India and Brazil seek to take a lead for the developing countries and have been joined by China, who now meet with the U.S. and EU to form a Group of 5 that would be key to building a consensus, were any possible. This is rapid progress for China in terms of its role, as China only joined the WTO at Doha. That said, China may not yet be comfortable with its position. What does it mean to be influential with developing countries which, as with other WTO members, demonstrate little enthusiasm for moving forward in this round of negotiations? Nor is China yet a leader in larger groups such as the G-19, which also so far cannot reach a consensus.

What would it require for China to actually take a lead in the WTO? It would have to take up the cause of improving this rules-based system and foster or at least not be at odds with its purpose of liberalization of international transactions. This would very much be in China’s interest (although there is no evidence that it sees things this way). There are selective issues that it could lead and still remain consistent with its avoidance of doing anything too dramatic in terms of further trade liberalization. For example, strong leadership for liberalization of ICT (information and communications technology products) would not only be pro-development for the developing world, but would distinctly favor products in which Chinese exports are highly competitive. It would be pro-development, because, for example, mobile phones are the best quick means to promote economic activity in less-developed countries.<sup>25</sup>

A second area for China to lead would be in liberalization as part of an Environmental Goods and Services Agreement (EGSA). Again, China would be doing well by going good. It is highly competitive in solar panels and is beginning to export low cost wind electric generating equipment.

More sensitive, but what should be of interest to China as well, would be WTO agreement on international sanitary and phytosanitary (SPS) standards. The presence of internationally agreed standards would help with China’s domestic regulation as well as assist China in its exports and avoid friction over its own import restrictions that it defends as being SPS-based. Similarly, leading the way toward international standards for toys would change a negative image of some of China’s exports.

Thus, there are areas in which China could emerge from its primarily negative roles of litigant, victim of trade remedy actions and contributor to inertia in its Doha Round, to become a leader. This change to a leadership role may occur at some time in the future but is not evident in China’s conduct in the WTO to date. Instead, China has helped stall the agriculture negotiations and has contributed to keeping the services negotiations from moving forward. The dominant impression of China in the WTO is of a country that is still trying to digest its accession to the organization. What is left for

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<sup>25</sup> An oft-cited example is African fishermen getting text messages of market prices so that they can choose which port to land their catch.



future analysis in terms of its impact on the WTO is China's very active role in negotiating regional trade agreements throughout Asia.

***d. China as a WTO litigant***

During its first five years of membership, China was reluctant to bring litigation.<sup>26</sup> During the first five years, not only was China reluctant to bring litigation against others, the reverse was also true. Perhaps it was the "honeymoon" effect. China very often joined cases as a third party (perhaps some 80% of all cases), gaining experience in litigation in this manner. It eventually was targeted as a respondent in a number of cases, and then brought five cases as a complainant, three against the United States and two against the European Union. At least one case involving China is currently active – China as a respondent over its export restrictions on raw materials (rare earths).

By participating as a third party in some seventy dispute settlement panels, China gained self-confidence as a litigant and valuable in-house expertise. It still always uses outside counsel (most often American trade law firms, at least once a French firm, and a Chinese firm; and in the auto parts case, the American firm spoke 90% of the time allotted to China<sup>27</sup>), however. Part of this outsourcing may be due to discomfort over arguing a case in English, the language in which its dispute settlement cases takes place. More important, perhaps, than the possible disability of having to deal in English as a litigant is the benefit to China of having the Chinese language as a shield when a potential complainant thinks of bringing a dispute case against China. It takes major resources to mount a case against China as many of the necessary documents would have to be translated from Chinese, and a complainant would need to rely on research in the Chinese language to ferret out evidence. Only a few WTO members have the resources to mount the required effort to bring a case against China, especially if the practices complained of consist of informal measures.<sup>28</sup>

China, as is the case with most developing countries, opposes transparency in dispute settlement. There is no access therefore to a special viewing room to watch via closed circuit television cases involving China, as opposed to cases where the U.S., the EU, Japan or Canada are the parties.

***Have we achieved the major political and economic goals that the United States hoped to achieve in China's joining the WTO?***

The United States has chosen to manage its trade relationships with China through the WTO insofar as formal rules are concerned<sup>29</sup>. The idea having been to promote

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<sup>26</sup> China was a co-complainant in the US steel safeguards case, however. The case was made moot by the Bush Administration's termination of the measure.

<sup>27</sup> USTR bars domestic counsel from participation in WTO proceedings, in a self-defeating policy that has been applied consistently by successive U.S. administrations.

<sup>28</sup> This is somewhat like the problems in an earlier era's problems with the Japanese Government's administrative guidance, or Korea's buy-national campaigns.

<sup>29</sup> There is practically no statement about the U.S. and China's relations that does not require further explanation. Problem-solving with China is most often attempted by the U.S., the EU, and Japan, for

market reforms in China, to welcome the integration of China into the world economy, to maintain reasonably smooth relations with China, to resolve trade problems with a minimum of friction, and to find more occasions for common ground with China in foreign policy matters and to promote social reforms, one can only conclude that the results have been mixed.

A number of thorny trade issues have been resolved: some through formal dispute settlement proceedings, and others simply by the fact that WTO rules and dispute settlement existed. Examples include the withdrawal by China of the discriminatory rebate of value-added taxes on semiconductors to domestic Chinese firms (resolved before a dispute settlement panel was formed); the suspension of forced technology transfer as part of the wireless LAN standard (known as "WAPI", resolved through Cabinet-level representations to the Chinese government); the removal of export subsidies pursuant to the U.S. request for consultations in the Famous Brands case; and the Chinese government's announced decision not to limit government procurement to Chinese-owned firms utilizing "indigenous innovation" (a potential resolution announced at a Joint Committee on Commerce and Trade meeting).

The U.S. has an ostensibly solid win record in the cases it has initiated against Chinese practices through formal dispute settlement procedures for violations of its WTO commitments. This statement would provide great comfort if one were assured that the problems encountered due to Chinese measures were largely justiciable under WTO dispute settlement proceeding. Looking at the National Trade Estimates Report, however, it can be readily seen that not all matters that are of trade concern to the United States are the subject of dispute settlement cases, far from it. In fact, there is only one new case pending at present, regarding export restrictions on raw materials.

There is another difficulty in assessing success in dispute settlement that goes beyond looking at a simple scorecard of WTO wins v. losses. 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.<sup>30</sup> The only way to evaluate a victory is to interview the ultimate beneficiaries of a case and seek to get (probably in confidence)

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example, bilaterally. In the U.S.-China case, the primary vehicles for seeking to resolve trade problems are the Joint Committee on Commerce and Trade and the Strategic and Economic Dialogue. However, the over-arching context is the existence of the WTO framework of obligations and rules.

<sup>30</sup> Sometimes one has the feeling that a WTO member government may be aware that it is crossing a line with a measure that will not prove sustainable by a WTO dispute settlement panel, but that it is relying on the delay inherent in WTO process to gain an advantage. It is probably more common for governments to take risks by pressing the envelope of the WTO's rules with grey area measures rather than adopting clearly WTO-inconsistent measures.

their full and honest assessment about the extent of commercial benefits going forward, past damage to commercial interests already having been suffered. 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 enforcement, but the Chinese market is still saturated with pirated software and DVDs. How does one assess a win when China agrees to have its government use licensed software when the market is still largely populated with counterfeits? At least superficially so far the U.S. has fared reasonably well with the cases it has brought.<sup>31</sup> The Audio/Visual and the Financial Information Services cases were heralded as coming out well.

A third level of difficulty in assessing whether WTO dispute settlement is sufficient to promote U.S. commercial interests is represented by the cases which have not been brought because many U.S. industries are still reluctant to endanger relations with China by being seen to have promoted a case brought by USTR. This is not unlike the reluctance over three decades on the part of Boeing to have a case filed against the EU for subsidies to Airbus, although the reluctance of foreign companies to press their governments to bring cases against China may also be eroding.

A further problem is the presence of potential ambiguities in any series of negotiated texts. There are areas in which China may believe that the WTO rules do not apply or at least do not apply effectively. When is a national standard justified and not a disguised restriction on trade? When is an SPS restriction based sufficiently on science? How can one judge whether opaque bidding procedures and bid criteria of state-owned enterprises are designed to favor domestic procurement? USTR wishes to litigate when it thinks there is a high likelihood of prevailing. Whether due to that sort of judgment being made or to industry reluctance to be supportive, WTO dispute settlement has been far from being a cure-all. The result is that private firms' dissatisfaction is growing with respect to the access their products are receiving to the Chinese market.

While China adopted sweeping pro-market reforms in a vast number of areas in order to join the WTO, if any believed that China would immediately become a market economy in every sense of that term—an economy hardly distinguishable from that of the United States, Europe, Canada or Australia, they would be greatly disappointed. The trade problems with China fill forty pages of USTR's Annual National Trade Estimates Report, the most attention by far that any country receives. In this regard China rivals Japan's prominence in reports of this kind in an earlier era<sup>32</sup>. And areas of concern with

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<sup>31</sup> In WTO and GATT litigation, the U.S. government has pressed cases where there is no U.S. export interest, but only a U.S. investment interest. A prime example of this is the case against the EU regarding banana exports from Central America.

<sup>32</sup> USTR's Summary on China trade problems as contained in the 2010 National Trade Estimates Report: *Industrial Policies: China's industrial policies limit market access by non-Chinese origin goods by protecting favored sectors and industries, using tools like standards, local content rules, and government procurement regulations. One example involves China's so-called "indigenous innovation" policies, which, among other things, provide preferences to products containing Chinese-developed IP for government procurement purposes.*

*Inadequate IPR Enforcement: In China, sales of infringing goods displace legitimate goods, and reduce U.S. access to China's market and other markets affected by China's infringing exports. Inadequate IPR*

respect to China continue to emerge. The Chinese economy is a work in progress. And the progress toward liberalization, like the motion of a pendulum, may have swung as far as it will go at present, and may now be regressing. There is ample reason for attention to be paid by policymakers of all major trading countries.

***Has the United States been able to satisfactorily challenge China's non-compliance under the WTO dispute settlement process?***

The question contains within it a constraining assumption of Chinese noncompliance – that there are numerous absolutely clear Chinese violations of the WTO that the U.S. has not addressed, or that China has flouted adverse WTO dispute settlement panel decisions. Neither of these statements would be accurate. When the U.S. government believes that it can persuade a panel that China is in violation of its international obligations, and has had the support of domestic industry to do so, it has brought cases. The results, while not perfect, have been reasonably positive. The question posed is, however, very different than asking whether the Chinese market is almost entirely open as a result of China's WTO accession. It is not.

China started out as very largely a nonmarket economy when it began its accession process, and there remain substantial vestiges of nonmarket attributes to its economy today. The Chinese government at all levels is far more interventionist in the Chinese economy than is the case in most of the major trading countries (although India and Brazil in their own ways are significant runners-up in this regard). The share of the Chinese economy that is accounted for by state-owned enterprises (SOEs) which according to reports was shrinking for over a decade may have stabilized and reportedly SOEs account for over 50% of China's industrial output<sup>33</sup>. Enforcement of intellectual property rights has improved above a very low baseline (e.g. there is a decent possibility in a number of courts in major cities to obtain IP protection through litigation) but is abysmal if one is talking about DVDs, consumer products, software, etc.

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*enforcement affects a wide range of products, including films, music, publishing, software, pharmaceuticals, chemicals, information technology, consumer goods, industrial goods, food products, medical devices, electrical equipment, automotive parts, clothing and footwear.*

***Services Restrictions:*** *China maintains prohibitions on foreign participation, restrictive licensing systems, foreign equity limitations, restrictions on scope of business and other measures that limit or block market access in a variety of services sectors. One example involves the telecommunications sector, where China has not approved any new suppliers of basic telecom services since joining the WTO in 2001 and maintains a web of restrictive policies that severely limits access to its value-added sector.*

<sup>33</sup> *SOEs still make up a substantial part of the national economy – roughly controlling 30 percent of the total secondary and tertiary assets, or over 50 percent of total industrial assets.* Jan 19, 2010. <http://blogs.worldbank.org/eastasiapacific/state-owned-enterprises-in-china-how-big-are-they>. For an estimate that the SOEs account for 23% of total assets see, Communiqué on Major Data of the Second National Economic Census (No.1), National Bureau of Statistics of China 2009-12-25. [http://www.stats.gov.cn/english/newsandcomingevents/t20091225\\_402610168.htm](http://www.stats.gov.cn/english/newsandcomingevents/t20091225_402610168.htm)

The stories are legion of foreign businesses finding that their anticipated performance in the Chinese market is far below what they had expected and had a right to expect. This shortfall from expectations cannot be attributable in substantial part to a lack of understanding of Chinese culture or consumer demand. That sort of excuse wore thin very quickly when Japan for a few decades alleged that foreign firms were "not trying hard enough" to penetrate the Japanese market.

During the last four years of speaking to Chinese and non-Chinese audiences alike, I have asked whether the door that China under the leadership of Deng Xiaoping had opened to foreign goods, services and investment, was in fact beginning to close. Chinese policy seems to have shifted to a significant degree. Policies that seemed negative, but only hortatory, such as "indigenous innovation", have been given practical effect through regulations and seeking conformity of actions by state-owned enterprises and other economic actors. There seems to be a noticeable ebbing in the tide of liberalization. Is the open door closing? Did that change in direction begin or was it accelerated under Hu Jintao and Wen Jiabao? Have China's leaders made a policy decision to return to greater state control of the economy with all that implies, including more subsidies and more barriers to imports and investment? There is current evidence to support this thesis.

How does this potential anti-liberalization policy direction fit with China's WTO commitments? Outside of major rounds of negotiations, the WTO is designed, or at least is currently utilized, to deal with issues that can be dealt with by a rifle shot remedy. Much as we might like it to exist, there is no "spirit of the WTO rules" to invoke. The WTO agreements consist of contractual commitments and one can either prove that they are violated or one cannot. When there is domestic industry support for pressing a case, and there has been a clear violation in the eyes of the USTR lawyers and presumably the Chinese government (MOFCOM, the Ministry of Commerce) thinks it will lose, China has repealed the measure in question (e.g. kraft linerboard antidumping investigation with respect to U.S. firms; discriminatory VAT rebate for domestic semiconductors) without going through the formal dispute settlement panel process. Where the WTO rules are more difficult to apply – to national standards (where purpose and effect must be weighed), or protection of intellectual property (where government enforcement efforts must be assessed), the "compliance" by China may be questioned but has evidently proved harder to challenge.

Where the case is highly fact-intensive, there is no substitute for a very substantial effort at obtaining data and engaging in very sophisticated analysis. This kind of effort can only be undertaken by entire U.S. or EU industries or very large companies, and in either case individual companies will be weighing the benefits of prosecuting a case against the risks of proceeding against a government upon whose favor it must rely.<sup>34</sup> This reluctance on the part of foreign industries to use public policy measures to deal with market access problems in China is waning, however. My strong sense is that there

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<sup>34</sup> Firms calculate whether the bringing of a case will result in China's cutting off their future path to success in the Chinese market.

is in process within China a movement toward greater implementation of restrictive promotional policies. This is having the unintended effect of uniting foreign business opinion to favor engaging more deeply with the governments of China's major trading partners to push back against these Chinese policies.

At some point, the question may be reached in some sectors, or perhaps more generally, whether the confluence of China's promotional policies constitutes "nullification and impairment" of promised benefits under the WTO agreements<sup>35</sup>. A positive finding by a WTO panel could lead to WTO-authorized foreign retaliation against China's exports.

### ***How Do Other WTO Members View China's Performance with Respect to Its WTO Obligations?***

This was not a question posed by the Commission, but fits well into its inquiry. The list of concerns voiced by other WTO member countries about China's practices is very long, and falls roughly into three categories: (1) policies and measures made the subject of formal disputes (listed above); (2) policies and measures that are raised as part of the Transitional Review Mechanism<sup>36</sup>; and (3) an array of policies and measures that are found in agendas of bilateral meetings between China and its trading partners, in government publications of other WTO member countries and in private sector materials (such as reports of foreign chambers of commerce based in China).

As part of its Protocol of Accession, China agreed to a Transitional Review Mechanism (TRM) consisting of annual reviews for a period of ten years.<sup>37</sup>

#### ***18. Transitional Review Mechanism***

##### ***1. Those subsidiary bodies<sup>38</sup> of the WTO which have a mandate covering China's commitments under the WTO Agreement or this Protocol shall, within***

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<sup>35</sup> European wind equipment producers have been very vocal about the loss of their market in China to domestic suppliers. Foreign share fell from a high of some 77% in 2004 to a low that some put at 5 to 10% in 2010. The purchasers are largely state-owned enterprises, utilities purchasing equipment for wind farms in pursuance of Chinese national and regional policies, and presumably seeing to maximize purchases of equipment that comport with China's National Indigenous Innovation Policy (NIIP -- although by its terms it applied to "government procurement"), and subject to standards that tend to exclude foreign companies' bids. No WTO case has been brought to date and at least one large European producer is still investing more in Chinese production facilities. For a detailed study on this sector, see the NFTC website: <http://www.nftc.org/default/Press%20Release/2010/China%20Renewable%20Energy.pdf>.

<sup>36</sup> This Commission has published the following description of the TRM: *the United States, for example, explicitly made an annual review of China's compliance with its WTO obligations an element of its national trade policy. In the bill that extended nondiscriminatory treatment (normal trade relations treatment) to the People's Republic of China, Congress expressly provided: It shall be the objective of the United States to obtain as part of the Protocol of Accession of the People's Republic of China to the WTO, an annual review within the WTO of the compliance by the People's Republic of China with its terms of accession to the WTO.* This provision is codified at 22 U.S.C. § 6931.

<sup>37</sup> *Protocol of the Accession of the People's Republic of China*, WT/L/432, 23 November 2001.

*one year after accession ... review, as appropriate to their mandate, the implementation by China of the WTO Agreement and of the related provisions of this Protocol.*

2. *The General Council shall, within one year after accession, and in accordance with paragraph 4 below, review the implementation by China of the WTO Agreement and the provisions of this Protocol.*

...

4. *The review . . . will take place after accession in each year for eight years. Thereafter there will be a final review in year 10 or at an earlier date decided by the General Council.*

A representative sampling of the most recent review, completed toward the end of last year, addresses the following policies and measures:

a. *Antidumping (AD) – procedural fairness.*

China is one of the top ten users of antidumping. It should be noted at the outset that this is a highly complex area of trade regulation, and it is difficult to start out in this area fresh and quickly become a very high volume processor of antidumping investigations without problems arising<sup>39</sup>. Member country complaints include, for example, Chinese petitioning companies not providing MOFCOM (China's Ministry of Commerce) with adequate non-confidential summaries of its submissions, depriving interested parties of an ability to adequately defend their interests. Similarly, there were concerns expressed over the level of detail provided by MOFCOM in its disclosure of dumping margin calculations and of the essential facts supporting the positions taken in the preliminary determination; timely access to administrators and favorable consideration of hearing requests; and a wish that administrators not resort to private meetings with selected parties as a principal means to obtain views of parties.

China has responded that it was in full compliance with its obligations under the Antidumping Agreement.<sup>40</sup>

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<sup>38</sup> Council for Trade in Goods, Council for Trade-Related Aspects of Intellectual Property Rights, Council for Trade in Services, and the Committees on Balance-of-Payments Restrictions, Market Access (covering also ITA), Agriculture, Sanitary and Phytosanitary Measures, Technical Barriers to Trade, Subsidies and Countervailing Measures, Anti-Dumping Measures, Customs Valuation, Rules of Origin, Import Licensing, Trade-Related Investment Measures, Safeguards, and Trade in Financial Services.

<sup>39</sup> The case of India is often cited as processing a vast volume of AD cases with a handful of staff, with the clear implication that there cannot be anything approaching WTO-compliant antidumping investigations and findings.

<sup>40</sup> *Chair's Report To The Council For Trade In Goods On Transitional Review Of China*, Committee on Anti-Dumping Practices, G/ADP/18, 28 October 2009.

b. *Market Access*<sup>41</sup>

The European Communities, Japan and the United States reiterated their concern regarding China's increased use of measures restricting access of their industries to key raw materials that serve as inputs for different sectors of interest, as they contend that the measures place foreign industries at a significant unfair disadvantage vis-à-vis China's domestic industries.

The EC also expressed concern over China's Compulsory Certification (CCC) Regulation, as imposing an excessive burden on importers, and asking China to set conformity assessment requirements on the basis of the actual risks associated with the products and consider simplifying procedures for lower risk products, allowing factory inspection in third countries; giving wider recognition of foreign test results; etc.

The EC further raised a question about the treatment of pharmaceuticals under the National Drug Reimbursement List (NDRL). The list, according to the EC, has not been updated since 2004, although the Chinese regulations require that the NDRL be reviewed bi-annually. New medicines have not had been able to obtain reimbursement.

The U.S. noted that China, after nearly eight years of WTO Membership, had still not provided any notification addressing a single sub-central governmental measure despite concerns expressed by Members in China's Accession Working Party Report. Further the U.S. complained that:

- In the area of SPS, China continued to maintain a number of measures that were non-transparent and appeared to lack scientific bases such as H1N1 restrictions, BSE-related bans, Avian Influenza bans, pathogen standards and residue standards.
- In the investment area, China continued to maintain various restrictions on foreign investment and continued to subject new investments and mergers and acquisitions to vague standards such as "national economic security".
- In the customs valuation area, the practices of China's customs administration still seemed to vary from port to port both in terms of customs clearance procedures and valuation determinations and, in some cases, giving rise to WTO concerns.
- In the area of technical barriers to trade, China continued to pursue the development of unique national standards despite the existence of well established international standards, apparently with the objective of protecting domestic companies from competing with foreign technologies and standards.

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<sup>41</sup> WORLD TRADE ORGANIZATION, G/MA/W/97, 22 September 2009, (09-4442)



### *b. Trade-related Intellectual Property Rights*

Perhaps the most frequent complaint about the China's performance as a WTO member is the amount of counterfeiting and piracy China's firms engage in affecting sales of competing products of other countries both in the Chinese market and in other markets. This is compounded in the views of WTO members participating in the Trade Review Mechanism process by the lack of proper access to the judicial or administrative enforcement systems; that criminal prosecution remains ineffective, that sanctions against infringers are insufficient to provide a deterrent, and that there is far too much discretion in administrative enforcement procedures. Civil procedures against infringing activities they contend, remain expensive, time-consuming, and difficult to obtain. Industry sectors affected by infringement within China include pharmaceuticals, electronics, batteries, auto parts, industrial equipment, toys, musical instruments, and numerous others.

The United States stated that it was critically important that China, in seeking to promote its domestic industries through indigenous innovation policies, ensure that these policies did not undermine the rights of non-Chinese owners of intellectual property rights or otherwise run violate WTO rules. The representative of China stated that "he was disappointed that the interventions this year did not differ very much from the ones in the past seven years", and that China had "strong doubts about the credibility of these figures and their ability to reflect the real situation".

"The representative of China defended the efficiency and skills of the judiciary in IP enforcement, noted the increase in criminal cases, and argued that the Chinese government had supplied materials demonstrating the effectiveness of China's enforcement. [C]ountries that had gone through different stages following the imperatives of their own development. Even so, 120 years after such systems of IP protection had been drawn up in developed countries, in spite of all the measures taken against piracy, these countries had not yet been able to eliminate piracy and counterfeiting."<sup>42</sup>

### *3. Other matters*

As noted, a large number of WTO committees carried out extensive reviews of their own and their reports inform the Transitional Review. These separate subsidiary reports were devoted to: Agriculture, Customs Valuation, Rules of Origin, Subsidies and Countervailing Measures, Safeguards, and Trade Related Investment Measures (TRIMs), as well as Technical Barriers to Trade and Sanitary and Phytosanitary Measures – each with its catalogue of disappointments and allegations of failings on the part of Chinese authorities.

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<sup>42</sup> Council for Trade-Related Aspects of Intellectual Property Rights, *Transitional Review under Section 18 of the Protocol of Accession of the People's Republic of China, Report to the General Council by the Chair*, IP/C/55, 11 December 2009.

### ***Has China achieved its goals in joining the WTO?***

*When PRC leaders decided to speed up WTO accession negotiations in the late 1990s, they had a clear goal in mind: to accelerate domestic reforms by introducing external pressures. By committing to China's WTO accession agreement, they attempted to overcome stumbling blocks that hindered the government's reform efforts. These reforms have been aimed at weakening the links between state-owned enterprises (SOEs) and bureaucrats and at streamlining and reinvigorating the declining state-owned sector, inefficient but powerful government agencies, and the poorly performing financial sector.*

Wang Yong, Associate Professor of International Political Economy and Director of the Center for International Political Economy, Beijing University. *China Business Review*, September-October 2006.

What did China hope to achieve in joining the WTO? In looking through Chinese sources for an answer to this question, there are no surprises:

- 1) *It was a logical next step in China's spurring growth through continuing domestic economic reform. Liberalization of trade was necessary to take advantage of liberalization of inward investment and to continue and expand the inflow of foreign investment.* China had before it the negative model of its own pre-liberalization period (pre-1978) as well as that of the Soviet bloc, as compared with the positive examples of the Asian tigers. Only in the context of opening its own market could China attract foreign investors with their advanced technologies, develop world-competitive industries, and (it was felt desirable at the time) move further away from State-ownership and a command economy. Joining the WTO gave much needed added impetus to instituting the rule of law and giving greater play to market forces. The impact of these forces and rules would themselves reform the Chinese economy, in many instances without direct state intervention.
- 2) *China needed to be assured of foreign markets for its exports.* While the Accession did include special safeguard clauses and trade remedies, there was a limit to the frequency and effects of their imposition: they would be reviewable by neutral WTO dispute settlement panels. Outside the WTO, there was very little other than diplomacy and economic power to determine whether Chinese goods would cross borders – a sort of law of the frontier. Businesses thrive on certainty. Unpredictability in the imposition of foreign trade barriers would undermine continued direct investment into China as well as the growth of indigenous industry aiming to enable China to serve world markets. Multinational companies needed to bring in capital equipment, materials and be able to be assured of export markets from a Chinese platform. China-based enterprises regardless of ownership needed to have the same assurance.
- 3) *China needed to be assured that supplies of raw materials, industrial inputs and food would be available without the imposition of arbitrary foreign export restrictions.* China's need for oil, minerals and food was and is vast, and it was foreseeable that

demand for these inputs would continue to expand. Supply assurance would be a strong motivating force.

- 4) *Absent China's WTO accession, the world could discriminate against Chinese goods and China as a destination for the world's raw materials, agricultural commodities and manufactured goods.* China could not afford to not only lack assurance of markets and supplies; it could not afford to be the only major trading country without that assurance. It is one thing to be denied access to supplies and to markets. This problem is compounded if other nations which were WTO members had guarantees of access and China did not.
- 5) *China needed a means to defend its trade interests in a routine manner.* WTO dispute settlement procedures provided a means for doing so. Diplomacy and economic strength could not be effectively deployed to resolve trade problems on all occasions.
- 6) *For China, with its grand history, and enormous national pride, to assume what it saw as its rightful role in world affairs, WTO membership was an essential prerequisite.* China could not aspire to leadership of any bloc of nations or with respect to any global economic subject without being a WTO member.

The short answer to the question posed by the Commission is, I believe, that China has very substantially attained its stated objectives. This may or may not be China's assessment, as it complains of foreign trade restrictions, but I think it is accurate. The Chinese economy has experienced continued remarkable growth. The international competitiveness of its firms and products has increased. Legal reforms not specifically called for by WTO Accession, but ancillary to it, for example an Antimonopoly Law, has not only been adopted but in an open and transparent manner with input from interested parties. China has become one of the top three trading countries in the world. Foreign investment has continued to be attracted. Foreign exchange reserves have increased markedly. China complains of the number of trade remedy actions brought against its exports, but the incidence of trade measures would have been much greater had it not joined the WTO.

Where China is probably falling short is in the area of domestic reforms, but this is not a failing that can be attributed to its being a WTO member; it is a failing by choice. The role of state-owned enterprises has not disappeared, far from it, and the sector may be growing. The intervention of the Chinese authorities at the central, provincial and local levels in the economy has not diminished as much as might have been hoped by Chinese reformers. Central planning has not been eroded as a major feature of the Chinese economy. The services sector is weak. Lending is distorted by industrial policy objectives and relationships, and this results in a misallocation of capital. These defects cannot be attributed to WTO Accession.

From another perspective, China has some complaints as to how it has been treated as a WTO member. This needs to be viewed in context, which is probably

impossible for the Chinese government official to do. In the history of world trade, every major new entrant has proved disruptive and controversial. This was true when new centers of pottery showed up in the Mediterranean and when iron replaced bronze in the Eastern Mediterranean and Middle East, and it was true when American wheat started landing in England in copious quantities in the mid-19<sup>th</sup> century. Europe's Common Agricultural Policy was a major concern to her trading partners in the last third of the 20<sup>th</sup> Century, as were Japan's exports of manufactured goods during the same period. Now it is China that is the primary focus of trade policy attention in the capitals of developed and developing WTO member countries alike, and this results in China being the number one target of other countries' restrictive trade measures – many of which may be entirely justified under the existing trading system's rules.

The fact that China has been the respondent in 18 dispute settlement cases since joining the WTO is not surprising. There were bound to be lapses given the nature of the Chinese economy and its size and growth path. As noted, in a number of these cases, China amended or withdrew its measure before litigation after the case had been formally initiated. However, this count is also misleading because in one sense it is overstating the number of measures being complained of: three of the cases by different complainants (U.S., EC and Canada) concerned certain measures on auto parts; two concerned certain tax refunds (U.S. and Mexico); three concerned distribution of financial information and services (EC, U.S. and Canada); three concerned certain grants, loans and other incentives (U.S. Mexico and Guatemala); and three currently pertain to export restrictions placed on raw materials (US, EC, Mexico).

No quantitative measure of disputes gives a clear qualitative picture. One of the major benefits of the WTO rules is that they exercise a significant deterrent effect wherever they are clearly applicable. However, the obverse is also true; the rules can act as an incentive to relax full compliance where they are ambiguous in application (e.g. in setting national standards that are not congruent with existing international standards).

China's seven cases in which it is the complainant against other WTO members are somewhat more revealing. All but one<sup>43</sup> concern trade remedy measures imposed either as safeguards (steel and tires) or antidumping and countervailing duty (AD/CVD) cases. In the case of the Bush Administration's steel safeguard action, it was a multilateral measure and the complaints were from many countries -- China was joined by 14 other WTO members as third countries in the proceeding. While this author believes the measure was fully justified, the WTO found against the United States. The measure had largely served its purpose when the Bush Administration terminated it after a finding adverse to its position, and cited non-WTO reasons for doing so. A case against the U.S. for its AD/CVD methodologies has been joined by 14 other WTO members. A case brought by China against the EU's imposition of antidumping duties on steel fasteners was joined by 11 other WTO members. The case on coated free sheet was a request for consultations only (with the United States). The remaining case is a footwear AD complaint against the EU that is still pending. China is also an active participant in

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<sup>43</sup> *U.S. Poultry*

other countries' cases, 65 of them, and as noted previously, this was presumably as much as anything to learn how dispute settlement worked.

Much more revealing are the 479 reported antidumping actions brought against China by WTO members (WTO data is through CY 2008). This represents 22% of all cases brought since January 1, 1995 (data that presumably includes China only since its WTO accession in 2001). This figure can be compared with data for a full 14 years, during which Korea was the target of 150 cases, Chinese Taipei (Taiwan) for 120 and the United States for 115. In other words, the PRC was the target of 24% more antidumping cases than the next three runner-up target WTO members put together. Of this treatment, China complains.

But what is the counter-factual? How many countries would have felt entirely free to discriminate against China, using unilateral quotas or prohibitively high tariffs, as a matter of their own discretion, either pursuant to a bilateral agreement with China or with no agreement? How many would have sought voluntary restraint agreements or orderly marketing agreements and got them? There may have been a plenitude of AD cases against China since it joined the WTO, but there clearly would have been a huge number of serious restraints placed on Chinese trade absent China's being inside the WTO.

An area that China complains of that is not remedied or even ameliorated (so far) by its WTO membership is that of export controls imposed for national security reasons. The WTO provides an exception from its obligations for measures so justified. Even to a greater extent than nonmarket economy treatment in antidumping cases, the subject most often raised by China in any discussion of trade issues with the United States is U.S. export controls placed on high technology goods. It is not clear that these controls will ever be justiciable in the WTO. The position that has often been taken by the United States is that what is in the national security interest of a sovereign nation only it can judge.

The bottom line: China believes, according to repeated statements of its officials, that its goods (and its potential imports of high technology goods and technologies) and its exports are being discriminated against.<sup>44</sup> However, this is not to say that China would be better off outside the safety of the WTO rules, or that its officials believe even for a moment that this would be the case.

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<sup>44</sup> It is not a violation for China to discriminate in its government procurement nor for other WTO members to discriminate against Chinese goods and services in their government procurement. While China pledged in its Accession process to join the Government Procurement Agreement, it still has not done so. As of the Transitional Review conducted last October, China had initiated negotiation for accession to the Government *Procurement Agreement* (GPA). "The application for accession into the GPA and Appendix I offer were submitted on 28 December 2007. In September 2008, China submitted G/C/W/630 Replies to the Checklist of Issues for Provision of Information Relating to Accession to the GPA. Up until now five rounds of negotiation on China's accession to the GPA have been held, and China has received initial requests from seven Members, namely the United States, the EC, Japan, Canada, Korea, Switzerland and Norway."

***Has China's entry into the WTO had a positive or negative impact on the economy and national security interests of the United States?***

This is a question that deserves intensive study. It is as far-reaching and complex a question as whether the formation of the European Common Market (now European Union) has been positive or negative for the United States. One can picture using a supercomputer and feeding in data on the impact on Boeing of competition from Airbus, on exports of U.S. poultry, and many thousands of other examples, both in terms of trade with Europe and exchanges with third countries. There is an old and unsettled argument about customs unions and free trade agreements as to whether they are more trade creating or trade distorting<sup>45</sup>. One thing that is always missing in an analysis of the past is the ability to assess with any great validity the economic effects of alternative courses of events using counter-factual assumptions. One has the instinctive feeling, perhaps because the U.S. strongly supported formation of the European Economic Community that the question is no longer asked whether the formation of the common market was on balance beneficial for the U.S. in economic terms. On the foreign policy side, the U.S. can assume that it got what it was seeking – so far.

With respect to China, the assessment has not been made of the economic costs and benefits to the United States of China joining the WTO. The experience has been both positive and not entirely positive. In any trade negotiation, there is a balance of what is given and what is received (viewed as negotiators do, in mercantilist terms – that is, increased market opportunities received for those granted). One factor that would have to be taken into account is the exchange rate, which when not justified by fundamentals, swamps any effects of tariff liberalization. There is a widespread conclusion in the economics profession that China's currency is undervalued by 20 to 40%, which would have the effective tariff in China the equivalent almost of the bound rates of India and Brazil in many cases. Factoring in an undervalued RMB would make a mockery of China's tariff concessions. It would also cause a gross imbalance in the concessions made as compared with those received. It would be the equivalent of the United States being able to rebate the equivalent amount of its direct (mostly, income) taxes on exports and charge the same amount on imports. In short, it would constitute a radical change in the commercial and economic relationship of the participants in the WTO.

To a Mexican producer of apparel, the added barrier it would face on its exports to China would be huge (assuming that its products would be otherwise cost competitive) and a massive violation of the WTO/GATT's export subsidy ban, and it would face an added Great Tariff Wall its goods seeking entry to China. But this is a somewhat oversimplified view. Exchange rates reduce the price of imported raw materials and sub-assemblies and parts with which China produces its exports. China's value-added for many products, particularly those assembled in export processing zones from foreign parts, may be relatively slight. In addition, in other instances, there are a great many

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<sup>45</sup>The Trade Minister of Korea in negotiating the U.S.-Korea Free Trade Agreement (KORUS), which still awaits approval by Congress, told an academic audience that his motivation is to achieve trade diversion favoring Korea over other suppliers to the U.S. market.

nontariff factors that govern trade flows. Where China has already required high domestic content (say for a foreign investor) to be eligible to supply its market, the exchange rate effect on foreign companies' sales could be negligible -- depending on the limited degree to which foreign inputs were required to produce the products in question. Or take the case where raw material imports are subject to contracts that allowed purchasing at concessionary prices in terms of a basket of freely floating currencies. Here too revaluation of the RMB would not affect trade in the short term as much as might be at first thought <sup>46</sup> And, more fundamentally, what would the equilibrium exchange rate of the RMB be if capital controls were entirely eliminated? The WTO is really absent (perhaps with leave) from something which must of necessity be of fundamental interest to it -- the value of currencies.

The product sector-specific effects of nontariff measures cannot be estimated other than by a very close analysis of the individual sector. If one examines government procurement, then in theory neither government is buying from the other, but this is just theoretical. If all Vitamin C is sourced in China, then VA hospitals buy from China. Similarly, where there is a product that is made only in the United States, perhaps a microprocessor, then some electronics products will be purchased by governments in China with that core element in them. Where local content requirements apply, or there was a desire to take advantage of lower wage rates in China, or an imperative felt to be closer to the market, or a wish to tap into the Chinese talent pool of less expensive engineers, each of these factors could have caused plants to locate in China. How then does one assess what trade effects would occur from RMB appreciation? In the event, the current WTO provisions have not been seen as an effective counter to currency undervaluation.

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So one is left with approximations, instinct, and assumptions. I do not believe that the United States would have been much more closed to China's exports in any

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<sup>46</sup> The actual effects of revaluation of the RMB v. the U.S. dollar are speculative at best. The top exports to from the United States to China are products such as aircraft, semiconductors, soybeans, scrap and other raw materials. To what extent are aircraft chosen on the basis of initial purchase price? Compared to what competitive products? The Euro is currently weak. Semiconductors are presumably largely exported. Would an exchange rate change alter the sourcing or quantity of semiconductors (heavily complex chips perhaps not made competitively in other countries)? Soybeans could be sourced in Brazil. Is Brazilian currency tied to the dollar so no competitive change would occur due to revaluation of the RMB? How much would scrap exports be increased by an RMB revaluation? Is this good for the U.S. economy? Much of the trade is presumably in industrial intermediates (perhaps in large part from offshore U.S. facilities)? What would the impact be on this trade, and what is the interest of U.S. policymakers in this trade? At some point services will account for an increasing proportion of US-China trade? Are these services exports likely to be much affected by what may be only a modest change in exchange rate? To be sure, there is head to head competition between China's exports and other countries goods, including some U.S. goods. And China is increasingly offering competition in goods the U.S. produces. Would there be any advantage China had in selling competing goods in the U.S. market (telecom switches, wind turbines) be dampened with a major alteration of currency relationships? Yes. But the effects cannot be readily estimated by economists. This is especially true if price is not a key determinant in SOE purchases for example, which may not be primarily driven by market factors.

across-the board manner had China not acceded to the WTO. One would have to assume that the United States government would have used its freedom from WTO rules to stop in many cases its own companies from sourcing product where costs were lowest, which in many cases, was and is China. In certain sectors, such as textiles and apparel, trade would have shifted to other low-wage countries if the U.S. restricted Chinese exports across-the-board.

I do not think that a compelling case can be made on the balance of positives and negatives for the United States economy of China's being in the WTO without a comprehensive in-depth analysis being performed, and that is not being done. Moreover, the results, while being comprehensive, would likely still be something well short of being beyond doubt.

In terms of foreign policy objectives, my assumption is that the relationship gets a "satisfactory" grade if there are only two grades allowed.

I believe that the United States is better off having China in the WTO, and that the alternative was in no way superior. The WTO is not a cure-all, however. If going forward China chooses to use measures that are designed to slip past its WTO obligations, where WTO disciplines are not clear-cut (such as has to date been the case of use of national standards) or the evidence is not available to support a dispute settlement case (such as might occur where there is adherence to national policies by supposedly independently-run commercial entities), or the political will to bring a case is absent, there will be adverse consequences for U.S. economic and commercial interests.

The first impact of WTO nonenforcement will be on China's rate of growth. Firms that exist in a nonmarket environment are rarely internationally competitive. National standards that are at odds with international standards provide a measure of protection, but the goods that result will not be internationally competitive. A forced pace of indigenous innovation could easily result in products that fail to win market acceptance within China or abroad. Emphasizing "created in China" as an exclusive approach would mean self-denial with respect to the world's best technologies if they don't happen to originate in China – and most do not. In today's world, no country has a monopoly on invention or innovation. To the extent that foreign firms are disadvantaged, they will ultimately pull back from engagement in China, to China's detriment. Inward investment flows, a primary engine of China's growth, would slow, and this may be occurring already. Inward flows of the latest technology, already impaired by concerns over lack of adequate intellectual property protections, would cease.

If China chose a course of extensive protectionism<sup>47</sup>, there would be damage to China's trade relations with other countries. Foreign firms would see their balance of

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<sup>47</sup> Without Chinese sources to cite, I would not attribute any particular Chinese policy or measure to a desire to restrict imports. China makes its policy choices for domestic not trade policy reasons, as was once pointed out to me by a Chinese academic trade expert. Trade policy (and WTO compliance) may well play a more central role in decision-making in the countries that founded the WTO and GATT – the United States and many of those comprising what is now the European Union.



interests shift from viewing China as an extremely important market requiring the quiet acceptance of restrictive Chinese policies to taking a more proactive stance to solving the problems China's protective and promotional measures create. Ultimately the work would be done to bring WTO cases and China could not necessarily rely on prevailing in them, leading to disruptions of its trade and investment.

It is said that China looks over its shoulder at the disappearance of the Soviet Union as a warning with respect to domestic political liberalization. It should look over its shoulder at the Japanese experience with respect to economics. The real political threat to China's stability is economic stagnation. The policy pendulum swinging back toward central planning and autarky could lead to the very result that China is seeking to avoid.

## RECOMMENDATIONS

I would close with two recommendations.

### 1. *Remedying the shortfalls in information and analysis*

In its first report after China's accession to the WTO, the Commission made the following observations:

*The United States Government is poorly organized to manage our increasingly complex relationship with China. We are not adequately informed about developments within China . . . and we dedicate insufficient resources to understand China.*<sup>48</sup>

Despite efforts to remedy this deficiency, and progress has been made, the knowledge of and understanding of China's industrial and commercial policies is woefully inadequate, and a price will be paid for these deficiencies. America's intelligence agencies are appropriately focused on counter-terrorism, as the immediate threat to the nation's security is to be found in the activities of those who would replicate 9/11 if they could. But ultimately, the ability of the United States to provide for its long term national security will depend on its technology, its innovation and productive capabilities -- on its industrial and scientific base. Our government and our private sector do not have adequate information on which to base its national policies and measures and private investment, respectively.

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<sup>48</sup> JULY 2002 - REPORT TO CONGRESS OF THE U.S. - CHINA SECURITY REVIEW COMMISSION - THE NATIONAL SECURITY IMPLICATIONS OF THE ECONOMIC RELATIONSHIP BETWEEN THE UNITED STATES AND CHINA,  
[http://www.uscc.gov/researchpapers/2000\\_2003/reports/excsum02.htm](http://www.uscc.gov/researchpapers/2000_2003/reports/excsum02.htm)

## *2. Adopting a national strategy.*

Doubling U.S. exports is a worthy goal, as is doubling the amount of Federal R&D funding. An emphasis on enforcement of existing agreements is also welcome. The National Trade Estimates report, the reports of the Transitional Review Mechanism all contribute to an information base. There is a Volcker Commission to deal with financial elements. But there is no synthesis designed to create an environment in which the U.S. economy will be able to sustain America's position in world affairs for future generations. While there are a number of disparate elements of a strategy that are identifiable, the central element is missing – the strategy itself.

The President's recent report on the National Security Strategy notes that America's strength is dependent on its prosperity. In a globalized world, competition from abroad will require a comprehensive plan, not in the sense of China's five year plans, but in creating an environment in which productive American enterprise will flourish.

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Note: The views expressed in this paper and oral testimony are personal and do not necessarily represent the views of any client or organization with which I am now or have been affiliated.

Alan Wm. Wolff  
June 9, 2010

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