

**U.S.-China Economic Challenges:  
Assessment of U.S. Trade Law Enforcement Effort with China**  
Testimony before the U.S.-China Economic and Security Review Commission  
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February 21, 2014

**I. Introduction**

Since China joined the WTO twelve years ago, it has become the world's number one exporter and the most important U.S. trading partner. But the growth in trade between the U.S. and China has been far from balanced. While annual U.S. exports to China grew by \$101 billion from 2001 to 2013, annual U.S. imports from China rose by nearly \$337 billion, more than three times as much.<sup>2</sup> As a result, our trade deficit with China has nearly quadrupled since 2001. Even though China accounted for less than eight percent of our exports to the world in 2013, it accounted for 19 percent of our imports and half of our trade deficit.<sup>3</sup> Our imbalanced trading relationship with China is thus one of the leading drivers of our growing overall trade deficit, which reached \$637 billion last year.<sup>4</sup>

As imports continue to outpace exports, American jobs are eliminated, our manufacturing sector weakens, critical technologies and know-how are lost, and communities across the nation suffer. Correcting this large and growing trade imbalance should be a top priority for policy makers, and addressing our trade deficit with China is a critical element of any such strategy. Ensuring that China abides by its international commitments and that our trade laws are effectively enforced are absolutely essential to addressing this growing threat to our economy and security.

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<sup>1</sup> This testimony is submitted in the author's personal capacity and not on behalf of the firm or its clients.

<sup>2</sup> Import and export statistics are from USITC Dataweb. Imports are general imports; exports are total exports.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

## **II. Assessment of Enforcement Efforts**

The Obama Administration has taken numerous important steps to try to address our trade imbalance by enforcing our trade remedy laws as well as the rules that China agreed to when it joined the WTO. The Administration enforced the China-specific safeguard mechanism for the first time in order to stem a surge in imports of passenger car tires from China. It also accepted a section 301 petition challenging China's trade and investment policies in the green technology sector, leading to a range of enforcement actions on behalf of the sector. The Administration has also filed eight requests for consultations with China at the WTO since 2009, covering issues ranging from export restraints on critical raw materials, prohibited subsidies to wind power equipment manufacturers and auto parts producers, the misuse of trade remedies, and restrictions on electronic payment services. The Administration has also pressed China on its lack of transparency at the WTO, and, in 2011, filed a counter-notification at the WTO subsidy committee to prod China into more timely and comprehensive disclosure of its subsidy programs.

The Administration has also secured numerous commitments from China to open its trade and investment regime and bring it into compliance with WTO rules through bilateral consultations. According to the GAO, since 2009 the U.S. has secured 75 trade and investment commitments from China through the U.S.-China Strategic and Economic Dialogue (S&ED) and 92 such commitments through the U.S.-China Joint Commission on Commerce and Trade (JCCT) (these totals include reiterations of prior commitments).<sup>5</sup> Though these commitments are valuable steps towards removing distortions in our trading relationship, most of them do not

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<sup>5</sup> United States Government Accountability Office, U.S. China Trade: United States Has Secured Commitments in Key Bilateral Dialogues, but U.S. Agency Reporting on Status Should Be Improved, GAO-14-102 (Feb. 2014).

include timeframes for completion, and there is no single system across the U.S. government for tracking China's compliance with these commitments.<sup>6</sup>

Despite these efforts, violations continue and our trade relationship grows more lopsided each year. In its most recent report on China's compliance with its WTO commitments, the U.S. Trade Representative (USTR) identified a wide range of areas in which China's compliance with WTO rules is lacking, including WTO-illegal and trade-distorting subsidies, discrimination against U.S. goods, services, and technologies, localization requirements, and inadequate protections for intellectual property rights. In many cases, effective action to address these violations is stymied by a continued lack of transparency in the Chinese legal system and, in some cases, an unwillingness of private actors to come forward with information for fear of retaliation. Combined with tight enforcement resources, these obstacles make it particularly difficult to bring enforcement actions against violations that involve complex factual situations on the ground in China. As a result, many of the WTO challenges the U.S. has brought are based on facial violations of WTO rules. While these violations certainly need to be addressed, mere repeal of a facially prohibited law or regulation is often not enough to ensure that U.S. companies and workers can compete on a level playing field in fact.

In other cases, the Administration has opted to pursue bilateral dialogue to resolve problems that could arguably be the subject of successful WTO challenges. This may be because the violation at issue would be complex to prosecute or is politically sensitive. For example, China provides tens of billions of dollars in export credits that do not appear to comply with global rules. U.S. ExIm Bank estimates China's export credits may near \$100 billion – triple the amount provided by the U.S. – and it has concluded that China's export financing does not

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<sup>6</sup> *Id.*

comply in practice with the terms of the *OECD Arrangement on Export Credits*.<sup>7</sup> Export credits that do not comply with the terms countries agreed to in the *OECD Arrangement* are prohibited subsidies under WTO rules.<sup>8</sup>

Rather than challenging China's export credits at the WTO, however, the U.S. is negotiating with China to agree to "international guidelines" for official export credits that, while "consistent with international best practices," also "tak[e] into account varying national interests and situations."<sup>9</sup> While the negotiations were originally intended to result in agreement by 2014, no final agreement has been announced to date. Moreover, the most recent public statements regarding the negotiations suggest that any agreement may now be limited to certain sectoral guidelines for ships and medical equipment.<sup>10</sup>

Similarly, the current Administration, like those before it, has opted to address China's continued manipulation of its currency through dialogue and consultation rather than enforcement action. Currency manipulation allows China to export goods at artificially low prices and artificially inflate the price of the goods it imports, putting U.S. workers and companies at a profound disadvantage. The U.S. could challenge these practices at the WTO, claiming that the undervaluation of China's currency: (1) constitutes a prohibited export subsidy within the meaning of various GATT articles and WTO Agreements; (2) violates GATT Article XV:4; (3) violates GATT Article II:3; and (4) nullifies and impairs benefits accruing to the United States. The WTO and IMF were designed to operate as a coherent, rules-based system to

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<sup>7</sup> Export-Import Bank of the United States, *Report to the U.S. Congress on Export Credit Competition and the Export-Import Bank of the United States* (June 2013) at 18.

<sup>8</sup> Agreement on Subsidies and Countervailing Measures, Annex I, item (k).

<sup>9</sup> U.S. Department of the Treasury, "Joint U.S.-China Economic Track Fact Sheet - Fourth Meeting of the U.S. China Strategic and Economic Dialogue (S&ED)," (May 4, 2012).

<sup>10</sup> U.S. Department of the Treasury, "Joint U.S.-China Economic Track Fact Sheet – Fifth Meeting of the U.S.-China Strategic and Economic Dialogue" (July 12, 2013).

prevent and redress exactly the type of trade-distorting currency practices that China is currently engaged in, and the U.S. should use those rules to the furthest extent possible.

In addition, the Administration has refused to take action against currency undervaluation in countervailing duty investigations, even though American industries harmed by Chinese imports have shown that the practice meets the statutory criteria for a countervailable subsidy. While the Administration has the authority to countervail currency undervaluation under the current law, Congress should enact the Currency Exchange Rate Oversight Reform Act of 2013 to clarify that fact and ensure that industries and workers that continue to be harmed by this unfair trade practice can obtain relief. The Administration has also not taken advantage of provisions in the law which allow it to self-initiate antidumping and countervailing duty investigations; self-initiation can be a valuable tool where domestic industries and workers are fragmented or otherwise lack the ability to petition for trade relief.

Finally, there are areas where the current rules are simply inadequate to allow the U.S. to take action to address issues that distort our trade with China. One such substantive issue is the unequal treatment of direct and indirect taxes under WTO rules. This unequal treatment allows China to rebate its Value Added Tax (VAT) on its exports, even those to a country that does not use a VAT system, the most important of which is the United States. In addition, even though the U.S. does not rebate taxes on goods we export, those goods are subject to China's VAT tax when they enter China. Based on 2013 imports and exports and a standard China VAT rate of 17%, this differential tax treatment conferred a nearly \$75 billion benefit on Chinese exports to the U.S., while imposing more than \$20 billion in taxes on U.S. exports, resulting in a total distortion to our trade relationship of \$95 billion in the past year alone.

Where current rules perhaps fall farthest short, however, is in the procedures that exist for monitoring and enforcing compliance. The WTO compliance apparatus, even if it were invoked as vigorously and consistently as possible, is simply not adequate to effectively address the scale and complexity of the known and unknown violations that continue in China. The WTO system is based on the premise that Member's legal systems are transparent, that rule of law prevails, and that Members will endeavor to bring themselves into compliance or endure retaliation once it is clear that a violation has occurred. The Chinese system, however, is far from transparent and the rule of law is far from prevalent. The Chinese government, moreover, appears willing to engage in blatant violations of WTO rules for as long as possible if those violations are of strategic and economic importance to China, regardless of whether or not such violations undermine the rules-based system. In addition, even where the current system is adequate to reveal and redress violations, it often takes years to do so, years in which our trade deficit continues to balloon, American jobs continue to be lost, and our industries continue to grapple with unfair competition.

Policymakers should therefore consider whether the U.S. should try to pursue the creation of enhanced enforcement mechanisms that are more suited to China's unique economic and legal system. While China would have to agree, through negotiations, to be subject to such procedures, their adoption could help the U.S. reap much more of the benefits we bargained for when China joined the WTO in 2001. Additional enforcement mechanisms may include independent monitoring and assessment of compliance in some areas, particularly technical areas, on a more rapid and consistent basis than can currently be achieved in WTO committees and dispute proceedings. It may also include more automatic penalties for violations in order to create stronger incentives to come into compliance. Another possible option would be to agree

to quantitative targets that would demonstrate progress towards a more balanced trade relationship, perhaps based on independent empirical studies regarding the trade flows that would be expected in an environment of full compliance. Such objective, quantitative targets should be easier to monitor and enforce than existing commitments, and their achievement could provide very tangible benefits to U.S. industries and workers.

### **III. Conclusion**

China is our largest trading partner, and continued violations by China distort trade and investment, contribute to our growing trade deficit, harm U.S. producers and workers, and undermine innovation. The Administration has made significant strides in its China enforcement efforts in recent years, and those efforts are paying off in successful WTO dispute settlement outcomes and negotiated commitments obtained bilaterally from China. As China's role in the world trading system continues to grow, however, its responsible compliance with the rules of the road remains sorely lacking.

There are a number of steps the U.S. could take to improve enforcement on its own, such as countervailing currency undervaluation, improving tracking of JCCT and S&ED commitments, devoting the resources to mount more fact-intensive and complex WTO challenges, and self-initiating trade remedy cases where fragmented domestic industries are unable to do so. However, over the long term, the effectiveness of even the most aggressive enforcement efforts is hampered by the current structure of the WTO's monitoring and dispute settlement apparatus. The U.S. should consider ways in which these enforcement tools can be strengthened to address the unique challenges posed by China's system.