

TESTIMONY
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BEFORE THE U.S.-CHINA ECONOMIC AND REVIEW SECURITY COMMISSION

HEARING ON
U.S. TOOLS TO ADDRESS CHINESE MARKET DISTORTIONS

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*THE BEST WAY TO ADDRESS CHINA'S UNFAIR POLICIES AND PRACTICES IS THROUGH
A BIG, BOLD MULTILATERAL CASE AT THE WTO*

TESTIMONY OF JENNIFER HILLMAN*

A. Introduction

Concerns in the United States and around the world with China's practices and policies have been growing with each passing year. These concerns were recently succinctly summarized in the statement made by U.S. Ambassador to the WTO Dennis Shea in a May 8, 2018 statement to the WTO General Council:

China . . . is consistently acting in ways that undermine the global system of open and fair trade. Market access barriers too numerous to mention; forced technology transfers; intellectual property theft on an unprecedented scale; indigenous innovation policies and the Made in China 2025 program; discriminatory use of technical standards; massive government subsidies that have led to chronic overcapacity in key industrial sectors; and a highly restrictive foreign investment regime.¹

The concerns are further laid out in two recent documents that this Commission is no doubt well aware of:

(1) the Section 301 report, issued by USTR on March 2, 2018,² which raises four core concerns:

First, China uses foreign ownership restrictions, such as joint venture requirements and foreign equity limitations, and various administrative review and licensing processes, to require or pressure technology transfer from foreign companies.

Second, China's regime of technology regulations forces U.S. companies seeking to license technologies to Chinese entities to do so on non-market-based terms that favor Chinese recipients and that violates China's national treatment requirements to treat foreign investors no less favorably than it treats domestic investors.

Third, China directs and unfairly facilitates the systematic investment in, and acquisition of, foreign companies and assets by Chinese companies to obtain cutting-edge technologies and intellectual property and generate the transfer of technology to Chinese companies. The role of the state in directing and supporting this outbound investment strategy is pervasive, and evident at multiple levels of government – central, regional, and local.

Fourth, China conducts and supports unauthorized intrusions into, and theft from, the computer networks of foreign companies to access their sensitive commercial information and trade secrets.

(2) the 2017 report to Congress on China's WTO compliance, issued by USTR January 2018, which is the sixteenth such report and examines nine categories of WTO commitments undertaken by China (trading rights, import regulation, export regulation, internal policies affecting trade, investment,

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¹ Statement as delivered by Ambassador Dennis Shea, Deputy U.S. Trade Representative and U.S. permanent Representative to the WTO, WTO General Council, Geneva, May 8, 2018.

² Findings of the Investigation Into China's Acts, Policies, And Practices Related to Technology Transfer, Intellectual Property, And Innovation Under Section 301 of the Trade Act Of 1974, Office of the United States Trade Representative, March 22, 2018, <https://ustr.gov/sites/default/files/Section%20301%20FINAL.PDF>.

agriculture, intellectual property right, services and legal framework), with this year’s report concluding that “the United States erred in supporting China’s entry into the WTO on terms that have proven to be ineffective in securing China’s embrace of an open, market-oriented trade regime.”³

Both reports raise the obvious question of what is the most effective tool or set of tools to address this myriad of interwoven and overlapping concerns?

My answer is that the best approach would be a big, bold, comprehensive case at the WTO filed by a broad coalition of countries that share the United States’ substantive concerns about China—even if they strongly oppose the Trump Administration’s unilateral tactics or the sequencing of actions that began with putting tariffs on steel and aluminum imports from those same countries that the United States needs to be working with on such an action at the WTO.

B. A Big, Bold WTO Case is the Best Tool to Address the Deep, Systemic China Problems

Why?

First, a broad and deep WTO case represents the best opportunity to bring together enough of the trading interests in the world to put sufficient pressure on China make it clear that fundamental reform is required if China is to remain a member in good standing in the WTO. The U.S. needs to use the power of collective action to impress upon both China and the WTO how significant the concerns really are. The United States simply cannot bring about the kind of change that is needed using a go-it-alone strategy. A coalition case also has the potential to shield its members from direct and immediate retaliation by China.

Second, a comprehensive WTO case would restore confidence in the WTO and its ability to address fundamental flaws in the rules of the trading system. As U.S. Ambassador Dennis Shea put it, “If the WTO wishes to remain relevant, it must – with urgency – confront the havoc created by China’s state capitalism.”⁴ If the WTO can be seen to be able to either bend or amend its rules to take on the challenges presented by China’s “socialist market economy” framework, then faith in the institution and its rules-based system can be enhanced, for the good of the United States and the world.

Third, the work to put together a coalition, to research and agree upon the Chinese measures to be challenged and the claims to be made, and to litigate in a coordinated way at the WTO would (hopefully) make it less likely that the United States would accept a limited agreement connected to the U.S.-China bilateral trade deficit. Certainly the United States’ partners in such a coalition would raise strong objection to the U.S. accepting an agreement under which China simply agreed to shift its purchases of soybeans from Brazil to the U.S. or its sourcing of energy products from Russia and Central Asia to the United States. Given that the Trump Administration has expended considerable political energy and clout in threatening the imposition of Section 301 tariffs on China, it is essential that they emerge from the process with measures to address the many real problems with China rather than simply addressing bilateral goods trade deficit.⁵ A coalition may be the best way to avoid a narrow, deficit-focused bilateral deal.

³ 2017 Report to Congress on China’s WTO Compliance, Office of the United States Trade Representative, January 2018, p. 2, <https://ustr.gov/sites/default/files/files/Press/Reports/China%202017%20WTO%20Report.pdf>.

⁴ Statement of Ambassador Dennis Shea, WTO General Council, May 8, 2018.

⁵ In Beijing on May 3-4, at its first high-level meeting with China following the release of the Section 301 report, the United States presented its draft framework (attached as Appendix A) for balancing the trade relationship with China, noting that “there is an immediate need for the United States and China to reduce the U.S. trade deficit with China,” and listing as the first of eight issues the request for a commitment by China to reduce the US-China trade deficit by \$200 billion.

C. The WTO Case Against China

The essential thrust of any WTO case should be to hold China to the specific commitments it made when it joined the WTO in 2001 and to the overarching understanding embodied in the Marrakesh Declaration that WTO members participate “based upon open, market-oriented policies.” The specific commitments China made are found in the texts of the WTO Agreements, China’s Protocol of Accession to the WTO, certain designated paragraphs of the accompanying Working Party Report, and China’s schedules of commitments.⁶ The schedules cover tariffs and non-tariff measures applicable to agricultural trade and industrial goods (commitments under the General Agreement on Tariffs and Trade, or GATT) and services (commitments under the General Agreement on Trade in Services, or GATS). The Protocol and Working Party Report also set out how China promises to fulfill its WTO obligations.

Every WTO case must be based on government measures (i.e., laws, regulations, rulings or practices), whether written or not, that violate one or more specific commitments or that “nullify or impair” a benefit provided to members of the WTO.⁷ It is this combination of both actual violations and the non-violation impairment of benefits that should be the focus of the case at the WTO.

Among the things that could be included in such a big, bold case are the following, understanding that this is not an exhaustive list:

1. Technology Transfer

One of the key findings of the Section 301 report is that the Chinese government uses both foreign ownership restrictions and administrative licensing and approvals processes to force technology transfer in exchange for either the investment approval itself or for the numerous administrative approvals needed to establish or operate a business in China.

However, China clearly committed (in one of the legally binding paragraphs of its Working Party report) that it would not condition investments on the transfer of technology:

The allocation, permission or rights for importation and investment would not be conditional upon performance requirements set by national or sub-national authorities, or subject to secondary conditions covering, for example, the conduct of research, the provision of offsets or other forms of industrial compensation including specified types or volumes of business opportunities, the use of local inputs **or the transfer of technology**. (emphasis added).⁸

⁶ Paragraph 342 of the Working Party report sets forth the specific paragraphs of the Working Party report that are considered to be incorporated into the Protocol itself. These paragraphs are therefore considered to be equally legally binding on China as the provisions in its Protocol or the text of the WTO Agreements.

⁷ The WTO Appellate Body, in *EC-Asbestos* described nullification and impairment: “Article XXIII:1(a) sets forth a cause of action for a claim that a Member has failed to carry out one or more of its obligations under the GATT 1994. A claim under Article XXIII:1(a), therefore, lies when a Member is alleged to have acted inconsistently with a provision of the GATT 1994. Article XXIII:1(b) sets forth a separate cause of action for a claim that, through the application of a measure, a Member has ‘nullified or impaired’ ‘benefits’ accruing to another Member, ‘whether or not that measure conflicts with the provisions’ of the GATT 1994. Thus, it is not necessary, under Article XXIII:1(b), to establish that the measure involved is inconsistent with, or violates, a provision of the GATT 1994. Cases under Article XXIII:1(b) are, for this reason, sometimes described as ‘non-violation’ cases.” Appellate Body Report, *EC – Asbestos*, para. 185.

⁸ Paragraph 203, Report of the Working Party on the Accession of China, WT/ACC/CHN/49, 1 October 2001. See also Section 7.3 of China’s Protocol of Accession.

While the Section 301 report clearly notes the difficulty in proving the technology transfer mandates, given that many of them are unwritten, and that others are done in the course of a negotiation between two ostensibly private parties (even though the Chinese entity may be either state-owned or have Communist Party members on its board), recent decisions of the WTO Appellate Body have made it clear that unwritten measures can be challenged.⁹ Given the clear commitment made by China and the WTO's Agreement on Trade Related Investments' (TRIMs) prohibition on treating foreign investment less favorably than Chinese investment, China's practices resulting in the forced or coerced transfer of technology should be challenged.

2. Discriminatory Licensing Restrictions

The second key finding of the Section 301 report is that China's regime of technology regulations does not allow U.S. (or other foreign firms) to license their technology (or choose not to license it) under the conditions and terms that they would like or that would prevail in a market economy. The Chinese regulations, among other things, discriminate against foreign technology, putting foreign technology importers at a disadvantage relative to Chinese companies and imposing additional restrictions on the use and enjoyment of technology and intellectual property rights simply because the technology is of foreign origin. This violates China's commitment to provide national treatment.

Unlike the concerns for the unwritten and under-the-table nature of the forced technology transfer practices, these measures are formal laws and regulations that are well-known to the United States and others. Indeed, Japan, the US and the EU have been raising concerns about these rules in the TRIPS Council and other WTO forums. Some of these same laws and regulations are the source of the United States' and the EU's May 2018 requests for consultations with China.

China's commitments here are clear: China ensured "national and MFN treatment to foreign right-holders regarding all intellectual property rights across the board in compliance with the TRIPS Agreement."¹⁰ In enacting laws and imposing regulations which discriminate against foreign holders of intellectual property rights and which restrict foreign right holders' ability to protect certain intellectual property rights, China has broken those commitments and violated its WTO obligations.

3. Outbound Investment and Made in China 2025

The third major finding of the Section 301 report is that China has engaged in a wide-ranging, well-funded effort to direct and support the systematic investment in, and acquisition of, U.S. companies and assets to obtain cutting-edge technology, in service of China's industrial policy. The report also notes that the role of the state in directing and supporting this outbound investment strategy is pervasive, and evident at multiple levels of government – central, regional, and local. The government has devoted massive amounts of financing to encourage and facilitate outbound investment in areas it deems strategic. In support of this goal, China has enlisted a broad range of actors to support this effort, including SOEs, state-backed funds, government policy banks, and private companies.

Concerns about these policies were heightened by the release by China's State Council in 2015 of its Made in China 2025 initiative, a "comprehensive blueprint aimed at transforming China into an advanced manufacturing leader [through] preferential access to capital to domestic companies in order to

⁹ See, for example, Appellate Body Reports, *Argentina-Measures Affecting the Importation of Goods*, WT/DS438/AB/R / WT/DS444/AB/R / WT/DS445/AB/R, adopted 26 January 2015.

¹⁰ Paragraph 256, Working Party Report, one of the legally binding paragraphs of China's Working Party report.

promote their indigenous research and development capabilities, support their ability to acquire technology from abroad, and enhance their overall competitiveness.”¹¹

Because much of the outward investment regimes and the Made in China 2025 plan are formal laws, regulations or program of the Chinese government, basic documentation for a WTO claim is relatively straightforward. However, the WTO rules have much less say over outward investment, making the nature of a WTO claim in this area more complicated. Nonetheless, there are some commitments that could form the basis for a violation claim, including a lack of reciprocity. For example, China stated that its IPR laws will provide that “any foreigner would be treated . . . on the basis of the principle of reciprocity.”¹² Yet as the Section 301 report amply documents, the Chinese administrative approval regime imposes substantially more restrictive requirements than that of the United States. U.S. firms face numerous barriers, such as sectoral restrictions, joint venture requirements, equity caps, and technology transfer requirements when they seek access to the Chinese market. Chinese firms do not face anything remotely approaching these types of restrictions when investing in the United States.

In addition, China’s outward investment regime and programs like Made in China 2025 could be challenged under the WTO’s GATT Article XXIII “non violation” given the non-market nature of China’s outward investment scheme. As the Section 301 report notes: “Market-based considerations. . . do not appear to be the primary driver of much of China’s outbound investment and acquisition activity in areas targeted by its industrial policies. Instead, China directs and supports its firms to seek technologies that enhance China’s development goals in each strategic sector.”¹³ Yet China, in joining the WTO, was becoming part of an organization calling for the “participation of . . . economies in the world trading system, based upon open, market-oriented policies and the commitments set out in the Uruguay Round Agreements and Decisions.”¹⁴

4. Theft of Trade Secrets and Other Intellectual Property

The fourth area identified by the Section 301 report are cyber intrusions into U.S. commercial networks targeting confidential business information held by U.S. firms, conducted and supported by the government of China. These cyber intrusions have allowed the Chinese government to gain unauthorized access to a wide range of commercially-valuable business information, including trade secrets, technical data, negotiating positions, and sensitive and proprietary internal communications.

The Section 301 report and the numerous documents and studies it reference, along with the Department of Justice indictment of Chinese government hackers for cyber intrusions and economic espionage,¹⁵ leave little doubt that China has engaged in serial theft of U.S. intellectual property rights, trade secrets in particular.

The clear claim under the WTO is a violation of the WTO’s Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). TRIPS covers the broad array of intellectual property rights (i.e., patents, copyrights, trademarks, trade secrets, industrial designs, geographical indications, integrated circuits) and provides both minimum standards of protection and a broad based requirement for enforcement. For example, Article 39 of the TRIPS Agreement provides that people and companies “shall have the possibility of preventing information lawfully within their control from being disclosed to,

¹¹ U.S. Chamber of Commerce, “Made in China 2025: Global Ambitions Built on Local Protections.”

¹² Paragraph 256 of China’s Working Party Report (one of the paragraphs that is legally binding).

¹³ Section 301 report, p. 148.

¹⁴ Marrakesh Declaration of 15 April 1994.

¹⁵ US. v. Wang Dong et al., (W. D. Pa., May 1, 2014).

acquired by, or used by others without their consent . . . ,” while TRIPs Article 41 imposes an affirmative obligation on all WTO Members: “Members shall ensure that enforcement procedures . . . are available under their law so as to permit effective action against any act of infringement of intellectual property rights covered by this Agreement, including expeditious remedies to prevent infringements and remedies which constitute a deterrent to further infringements.” Engaging in and permitting the theft, whether through cyber intrusions or not, is a violation of the basic requirement that China’s laws and its efforts to enforce intellectual property rights “must have real force in the real world of commerce.”¹⁶

5. Investment Restrictions

As noted above, Chinese government officials at times use China’s current foreign investment approval process to restrict or unreasonably delay market entry for foreign companies, to require foreign companies to take on a Chinese partner, or to extract valuable, deal-specific commercial concessions as a price for market entry.¹⁷ Foreign companies are often told that they will have to transfer technology, conduct research and development in China or satisfy performance requirements relating to exportation or the use of local content if they want their investments approved.¹⁸

In addition, in the name of security, a number of additional restrictions have been placed on foreign investment. The *National Security Law* includes a more restrictive national security review process and other significant restrictions on foreign investment, such as restrictions on the purchase, sale and use of foreign ICT products and services, cross-border data flow restrictions and data localization requirements.¹⁹

The *Catalogue Guiding Foreign Investment in Industry (Foreign Investment Catalogue)*, imposes significant restrictions in key services sectors, extractive industries, agriculture and certain manufacturing industries.

A number of the provisions in these laws and catalogues violate the commitment China made in its Protocol of Accession: “China shall ensure that . . . the right of importation or investment by national and sub-national authorities, is not conditioned on: whether competing domestic suppliers of such products exist; or performance requirements of any kind, such as local content, offsets, the transfer of technology, export performance or the conduct of research and development in China.” (Protocol, Section 7.3) These also violate China’s basic commitment to national treatment, requiring that China treat foreign companies no less favorably than it treats Chinese companies.²⁰

6. Subsidies

Many regard the WTO’s difficulty in regulating subsidies as among its greatest weaknesses, particularly when it comes to the size and the nature of the subsidies being provided in China. For example, subsidization and the resultant overcapacity have been problems in China, particularly with State-Owned-

¹⁶ James Bacchus, “How the World Trade Organization Can Curb China’s Intellectual Property Transgressions,” CATO, March 22, 2018.

¹⁷ 2017 Report to Congress on China’s WTO Compliance, USTR, January 2018, pp. 83-95.

¹⁸ For example, in October 2012, MOF, MIIT and MOST issued two new measures establishing a fiscal support fund for manufacturers of New Energy Vehicles (NEVs) and NEV batteries. As foreign automobile manufacturers are required to form 50-percent joint ventures with Chinese partners, these requirements could effectively require them to transfer core NEV technology to their Chinese joint-venture partners in order to receive the available government funding.

¹⁹ The recently enacted *Cybersecurity Law* adds additional restrictions to those in the *National Security Law*.

²⁰ China’s basic national treatment commitment is underscored in Paragraph 18 of the Working Party report (one of the legally binding paragraphs): “The representative of China further confirmed that China would provide the same treatment to Chinese enterprises, including foreign-funded enterprises, and foreign enterprises and individuals in China.”

Enterprises (SOEs) which are provided with a variety of free or below-cost resources (such as land and raw materials), raising questions as to whether inputs provided by such SOEs to downstream manufacturers should be treated as government subsidies. The provisions of the WTO's Agreement on Subsidies and Countervailing Measures (ASCM) makes proving the existence of such subsidies difficult. Specifically, the agreement defines a subsidy as a "financial contribution by a government or any public body."²¹ The WTO Appellate Body has interpreted "public body" to mean government or governmental entities that exercise governmental functions²² – i.e., that the entity must possess, exercise, or be vested with "governmental authority" and be performing a "governmental function." This interpretation effectively takes Chinese SOEs out of the definition of subsidy and renders the WTO framework ineffective in addressing these cases.

Second, demonstrating the existence of a subsidy also requires showing that a benefit was provided to the subsidy recipient, with "benefit" being defined as making the recipient better off than they would have been absent the subsidy. Such a demonstration requires a comparison to a market benchmark to determine whether the terms of a loan or the price of a government purchase were more favorable than market-based terms. Because of the nature of China's economy, benchmarks are often hard to prove.

Moreover, remedies available under the WTO subsidy rules are perceived to be inadequate in addressing concerns about China. The ASCM does not provide an outright ban on subsidies but rather allows countries to take one of two actions when faced with subsidized goods: 1) countervailing duty actions if the subsidized goods are coming into their markets and causing injury to their domestic producers, with the amount of the duty equal to the portion of the cost of production that has been covered by the subsidy, or 2) adverse effects cases at the WTO, if the damage from trade in the subsidized product is causing harm in third-country markets. The problem with countervailing duties is that they may simply push the subsidized goods into other markets, thus suppressing prices. The problem with adverse effects cases is that remedies in the WTO are prospective only so the requirement to "remove the adverse effects of the subsidy" often does little to dismantle the capacity that China has built to produce those goods in the first place.

In recent years, it appears that China has begun to tie subsidies to lists of qualified manufacturers located in China. For example, the central government and certain local governments provide subsidies in connection with the purchase of NEVs, but they only make these subsidies available when certain Chinese-made NEVs, not imported NEVs, are purchased. China appears to pursue similar policies involving NEV batteries, leading to lost sales by U.S.-based manufacturers.

China made two basic commitments with respect to subsidies when it joined the WTO: 1) to notify the WTO of all the subsidies it granted or maintained, and 2) to eliminate all export contingent and import substitution subsidies. It also made general national treatment commitments not to discriminate against foreigners. It appears that China is violating all three commitments. The hope in bringing a broad challenge would be to force a long-overdue discussion about what the WTO can do to change its approach to disciplining subsidies.

7. Export Restraints

In some situations, China has used its border taxes to encourage the export of certain finished products over other finished products within a particular sector. For example, in the past, China has targeted value-added steel products, particularly wire products and steel pipe and tube products, causing a surge in

²¹ See Article I of the SCM Agreement. Assuming that a measure is a subsidy within the meaning of the SCM Agreement, it nevertheless is not subject to the SCM Agreement unless it has been specifically provided to an enterprise or industry or group of enterprises or industries.

²² See *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R.

exports of these products, many of which ended up in the U.S. market. Furthermore, despite its commitments to the contrary, China has taken no steps to abandon its use of trade-distortive VAT export rebates. Export taxes on any products other than those specific in Annex 6 to China's Protocol of Accession are prohibited and ripe for challenge.²³

8. Standards

China seems to be actively pursuing the development of unique requirements, despite the existence of well-established international standards, as a means for protecting domestic companies from competing foreign standards and technologies. Indeed, China has already adopted unique standards for digital televisions, and it is trying to develop unique standards and technical regulations in a number of other sectors, including, for example, autos, telecommunications equipment, Internet protocols, wireless local area networks, radio frequency identification tag technology, audio and video coding and fertilizer as well as software encryption and mobile phone batteries. This strategy has the potential to create significant barriers to entry into China's market, as the cost of compliance will be high for foreign companies, while China will also be placing its own companies at a disadvantage in its export markets, where international standards prevail. There are also concerns that integrating its domestic standards requirements into its certification or accreditation schemes would make them de facto mandatory.²⁴

China's standards are subject to the WTO requirements on standards, both those contained in the Agreement on Sanitary and Phytosanitary Standards (SPS Agreement) (relating to food, animal and plant standards) and the Agreement on Technical Barriers to Trade (TBT). Both Agreements contain basic national treatment requirements, preferences for the harmonization of standards with those set by recognized international standards organizations and a basic requirement that standards not be more trade restrictive than necessary to fulfill a legitimate objective. To the extent that China's standards can be shown to have effectively created unnecessary obstacles to trade or to have unreasonably departed from international standards, they can be challenged at the WTO.

9. Services

China's commitments with respect to services are those found in its GATS (General Agreement on Trade in Services) schedules and in more recent commitments China has made to improve on those initial commitments. The problem is that in a number of sectors, China has not followed through previously agreed upon changes. For example:

Insurance: While China allows wholly foreign-owned subsidiaries in the non-life (i.e., property and casualty) insurance sector, the market share of foreign-invested companies in this sector is only about two percent. Some U.S. insurance companies established in China sometimes encounter difficulties in getting the Chinese regulatory authorities to issue timely approvals of their requests to open up new internal branches to expand their operations. In November 2017, China announced that it would be easing certain of its foreign equity restrictions in the insurance services sector, but to date it has not done so.

Securities and management services: China only permits foreign companies to establish as Chinese-foreign joint ventures, with foreign equity capped at 49 percent. In November 2017, China

²³ "China shall eliminate all taxes and charges applied to exports unless specifically provided for in Annex 6 of this Protocol or applied in conformity with the provisions of Article VIII of the GATT 1994." Section 11.3, China's Protocol of Accession.

²⁴ 2017 Report to Congress on China's WTO Compliance, USTR, January 2018, pp. 60-61.

announced that it would be easing certain of its foreign equity restrictions in the securities and asset management services sectors, but to date it has not done so.

Legal services: China has issued measures intended to implement the legal services commitments that it made upon joining the WTO. However, these measures restrict the types of legal services that can be provided by foreign law firms, including through a prohibition on foreign law firms hiring lawyers qualified to practice Chinese law, and impose lengthy delays for the establishment of new offices.

The WTO case should work to hold China to all of the commitments it has made to open up its services sector.

10. Agriculture

U.S. exporters continued to be confronted with non-transparent application of sanitary and phytosanitary (SPS) measures, many of which have appeared to lack scientific bases and have impeded market access for many U.S. agricultural products. China's seemingly unnecessary and arbitrary inspection-related import requirements also continued to impose burdens and regulatory uncertainty on U.S. agricultural producers exporting to China, as did the registration and certification requirements that China imposes, or proposes to impose, on U.S. food manufacturers.²⁵

Any SPS measures adopted without a sound scientific basis or without a risk assessment or without being based on certain international standards are clearly subject to challenge at the WTO, with past cases indicating a high likelihood that any such measures would be struck down. The inspection-related requirements may also violate the WTO's Agreement on Preshipment Inspection, which contains both non-discrimination and transparency requirements.

11. Transparency

The issue of transparency and access to China's laws, regulations and rules was of key concern to WTO members when China joined in 2001. China's Protocol of Accession and five paragraphs of its Working Party clearly commit China to making all laws, regulations and other measures pertaining to trade readily available and, upon request, available prior to their implementation or enforcement, along with making them available in one or more of the official languages of the WTO (English, French and Spanish). As the following examples show, China has not lived up to these commitments and can be challenged on these (and other) transparency failures at the WTO:

Publication of laws: While trade-related administrative regulations and departmental rules are more commonly (but still not regularly) published in the journal, it is less common for other measures such as opinions, circulars, orders, directives and notices to be published, even though they are in fact all binding legal measures. In addition, China does not normally publish in the journal certain types of trade-related measures, such as subsidy measures, nor does it normally publish sub-central government trade-related measures in the journal.

Notice and comment procedures: At the May 2011 S&ED meeting, China committed to issue a measure implementing the requirement to publish all proposed trade and economic related administrative regulations and departmental rules on the website of the State Council's Legislative Affairs Office (SCLAO) for a public comment period of not less than 30 days. In April 2012, the SCLAO issued two measures that appear to address this requirement. Since then, despite continuing U.S. engagement, little noticeable improvement in the publication of departmental rules for public comment appears to have taken

²⁵ 2017 Report to Congress on China's WTO Compliance, USTR, January 2018, p. 96.

place, even though China confirmed that those two SCLAO measures are binding on central government ministries.

12. Non-violation

Last, but certainly not least, a broad and deep case at the WTO should include a non-violation claim under Article XXIII of the GATT, focused on the myriad of ways in which China's economy fails to meet the Marrakesh Declaration that the WTO was designed as a world trading system "based upon open, market-oriented policies." The non-violation clause of Article XXIII represents a real-world attempt to solve the broader problem of contractual incompleteness. It provides a legal cause of action against measures that do not violate the treaty but that nevertheless upset the reasonable expectations of the parties and can be aimed at policies that might otherwise be beyond the reach of the GATT/WTO agreements.²⁶ Non-violation claims have been rare.²⁷ WTO members generally agree that "the non-violation nullification or impairment remedy should be approached with caution and treated as an exceptional concept. The reason for this caution is straightforward. Members negotiate the rules that they agree to follow and only exceptionally would expect to be challenged for actions not in contravention of those rules."²⁸

However, the wide-spread concerns with China's economy and the difficulties it has raised for WTO members suggests that this is indeed time for an exceptional approach. As made clear in Harvard Law Professor Mark Wu's "China Inc." analysis, China's economy is structured differently from any other major economy and is different in ways that were not anticipated by WTO negotiators.²⁹ It is the complex web of overlapping networks and relationships, both formal and informal, between the state, the Communist Party, SOEs, private enterprises, financial institutions, investors and others with Chinese government oversight over state assets (SASAC), financial sector organization (Central Huijin Investment Ltd.), heavy state planning, placement of Communist party officials in key positions, specific forms of corporate networks and state-private sector linkages that make China's economy so unique and so hard for the trading rules to deal with.³⁰

It is exactly for this type of situation that the non-violation nullification and impairment clause was drafted. The United States and all other WTO members had legitimate expectations that China would increasingly behave as a market economy—that it would achieve a discernable separation between its government and its private sector, that private property rights and an understanding of who controls and

²⁶ Article XXIII provides:

Nullification or Impairment

1. If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as the result of

- (a) the failure of another contracting party to carry out its obligations under this Agreement, or
- (b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement, or
- (c) the existence of any other situation,

the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers to be concerned. Any contracting party thus approached shall give sympathetic consideration to the representations or proposals made to it.

²⁷ "Although the non-violation remedy is an important and accepted tool of WTO/GATT dispute settlement and has been 'on the books' for almost 50 years, we note that there have only been eight cases in which panels or working parties have substantively considered Article XXIII:1(b) claims." Panel Report, *Japan – Film*, para. 10.36.

²⁸ Panel Report, *Japan – Film*, para. 10.36.

²⁹ Mark Wu, "The 'China, Inc.' Challenge to Global Trade Governance," *Harvard International Law Journal*, Vol. 57, Spring 2016, pp. 261-324.

³⁰ Mark Wu at 284.

makes decisions in major enterprises would be clear, that subsidies would be curtailed, that theft of IP rights would be punished and diminished in amount, that SOEs would make purchases based on commercial considerations, that the Communist Party would not, by fiat, occupy critical seats within major “private” enterprises and that standards and regulations would be published for all to see. It is this collective failure by China, rather than any specific violation of individual provisions, that should form of the core of a big, bold WTO case. Because addressing these cross-cutting, systemic problems is the only way to correct for the collective failures of both the rules-based trading system and China.

D. The Time is Ripe for a WTO Case Now

The suggestion to bring a bold WTO case against China now certainly begs the question: if such a case is so clearly warranted and the problems have persisted for so long, why hasn’t it been brought before now?

Among the reasons may be the following:

First, bringing a collective case, with multiple complainants, is never easy, as it requires tremendous coordination of both the legal tasks of drafting and pleading and of the substantive arguments to be made, which may favor one country more than others or raise concerns for some but not all of the coalition. Only a handful of the 547 WTO complaints brought to date have been brought by a coalition of countries, but for this case to be most effective, a coalition is needed. And many of the potential coalition partners have been working with the U.S. in other fora, including the OECD, the G-7, and the Global Forum on Steel Excess Capacity. The need to pool together both the evidence and the political power of as large a coalition as can be mustered will be important to achieving sustained pressure at the highest levels on China.

Second, many countries in the past have been reluctant to bring WTO disputes unless they were virtually assured of a victory. No one wanted to lose, given the diplomatic and political fallout that can occur from one country accusing another foreign sovereign of being a rules scofflaw. But in light of the depth and breadth of the concerns about China, now is the time to throw caution to the wind and bring a big case that challenges a number of both specific measures and systemic matters, assuming there is sound evidence to ensure that each claim has been brought in the good faith required by the WTO’s Dispute Settlement Understanding (DSU).³¹ Moreover, a number of the most likely applicable provisions have not yet been tested, against China or any other country. In the past when tried for the first time, WTO rules have generally been found to work.

Third, many countries (and the companies within those countries) have been reluctant to take on China for fear of retaliation by China, in ways both obvious and hidden.³² Countries fear that China will

³¹ Article 10 of the DSU provides: “It is understood that requests for conciliation and the use of the dispute settlement procedures should not be intended or considered as contentious acts and that, if a dispute arises, all Members will engage in these procedures in good faith in an effort to resolve the dispute.”

³² As stated in the Section 301 report (at 9): U.S. companies “fear that they will face retaliation or the loss of business opportunities if they come forward to complain about China’s unfair trade practices. . . . Multiple submissions noted the great reluctance of U.S. companies to share information on China’s technology transfer regime, given the importance of the China market to their businesses and the fact that Chinese government officials are ‘not shy about retaliating against critics.’ For example, a representative of the Commission on the Theft of American Intellectual Property testified at the hearing: ‘American companies are intimidated and reticent over the issue, especially in China. There they risk punishment by a powerful and opaque Chinese regulatory system.’ In addition, according to the U.S. China Business Council, their member companies do not presently have ‘reliable channel[s] to report abuses and to appeal adverse decisions...without fear of retaliation.’”

impose trade remedies or other measures on their exports or deny needed permits to their companies or file WTO challenges, all in direct response to claims of unfair trade practices, forced technology transfers or intellectual property theft. While not a perfect shield, bringing a broad, coalition-based case would lessen the likelihood that China would or could effectively retaliate against all of the coalition partners, much less the many industries and companies that would be standing behind the case.

Fourth, bringing cases against China has often presented very difficult evidentiary hurdles, as much of the information and evidence needed to support a claim, particularly a claim based on unwritten rules or practices, can be quite difficult to obtain. As noted above, one of the ongoing complaints of the United States and others is the lack of transparency in China, particularly around the issue of granting licenses or permits. As stated in the Section 301 report: “The fact that China systematically implements its technology transfer regime in informal and indirect ways makes it ‘just as effective [as written requirements], but almost impossible to prosecute.’ . . . Nevertheless . . . confidential industry surveys, where companies may report their experiences anonymously, make clear that they are receiving such pressure. The lack of transparency in the regulatory environment, the complex relationship between the State and the private sector, and concerns about retaliation have enabled China’s technology transfer regime to persist for more than a decade.”³³ However, it is clear that over the course of the last decade or more, through the work of this Commission, USTR and other U.S. government agencies, along with numerous business and industry groups, that a substantial amount of evidence has been collected here in the United States. The combination of the extraordinarily comprehensive and well-documented Section 301 Report, the annual reports of this Commission, and the annual USTR report to Congress on China’s WTO compliance already contain ample evidence to support all of the potential claims noted above. Add to that the work done in the EU, Japan, Canada and others, and at the OECD along with other multilateral institutions, and it becomes clear that there is more than sufficient evidence to demonstrate that China’s economy is operating in ways that undermine the WTO’s rules-based, market-based system. Indeed, one of the many benefits of bringing a case as a coalition is that each member of the coalition can contribute the evidence that they have collected and the experience of their companies.

Fifth, some would argue that WTO cases have already been tried, with some success and some failure. It is true that China has been challenged in 40 disputes brought to the WTO’s dispute settlement system, with 22 of those cases arising from complaints filed by the United States, eight coming from the EU, four from Mexico, three from Canada, with Japan and Guatemala also bringing claims against China.³⁴ And a number of them (at least 15) have found against China. While the actual extent of Chinese compliance with WTO rulings can be questioned, in a number of cases, China has removed or amended its offending measures and in five others, China has reached a settlement agreement with the complaining party. The problem with many of these cases is that the challenges were relatively narrow, limited to a few Chinese measures, or to a particular industry or set of producers. While some of the more recent cases, including in particular the case on subsidies for aluminum and the Section 301-related case on IPR violations, have attempted to bring a specific case to showcase the underlying and more systemic problems, no panel has yet been requested in those cases and it remains to be seen whether a single case can provoke a more systemic response from China.

³³ Section 301 report at 22.

³⁴ See the attached Appendix B for a full list of the cases brought against China and their outcomes. Note that for eight of the cases, no panel has been requested, for two of the cases the panel is working on the case, and for two others, the DSB has agreed to establish the panel but the actual panelists to hear the case have not yet been appointed.

As a result, some have come to believe that the WTO, as the 2017 USTR report to Congress states, “is not effective in addressing a trade regime that broadly conflicts with the fundamental underpinning of the WTO system.”³⁵ I disagree. I do not believe that the kind of broad case, with claims across sectors and across legal regimes, has been tried. No one, for example, has challenged the Chinese system of intellectual property rights or technology transfers *as a whole*. The WTO, therefore, has not been given the opportunity to show what can be done to save its core provisions. Yet it is just such a systemic case that could provide the basis and the incentive to craft a legal remedy that could be beneficial to all sides.

E. Objectives of Such a WTO Case

Most WTO disputes have as their goal a ruling by the Dispute Settlement Body that the measures complained about violate one or more provisions of the WTO Agreements, after which the responding party brings its measures into compliance, often by removing or amending the offending measures. Here, while one of the goals would indeed be to seek certain specific rulings of that type, the goals would be much broader—

- 1) to seek a common understanding of where the current set of rules are failing and need to be changed (with disciplines on subsidies at the top of that list);
- 2) to begin the process of scoping out exactly what those rule changes would look like to accommodate the views of the broader WTO membership;
- 3) to seek recognition from China of where and to what degree its economic structure can or cannot fit within a fair, transparent and market-based trading system; and
- 4) to give China the opportunity to make a choice that is its sovereign right to make – whether it wants to change its system to one that does fit within the parameters of the WTO or not.

As former USTR official Harry Broadman put it, “There’s no right or wrong here. If China’s choice results in conduct that does not square with the rules of the WTO . . . so be it. Beijing should then exit the WTO gracefully or be shown the door.”³⁶ The hope would be that both China and the coalition of parties to the dispute would appreciate that the trading system is better off with China as part of it, that the WTO rules are in some places and in some ways part of the problem and need to be changed, but that tinkering at the margins for China will not suffice.

F. The U.S. Unilateral Alternatives

If the best option outlined above proves impossible, then the United States has other options for action. All of these are much inferior choices to a coalition-based WTO case because all of them involve unilateral action by the United States. As we have seen already, unilateral action is most likely to attract retaliation from China and least likely to get at the heart of the problem. Moreover, other than trade remedies, most of these unilateral responses would likely result in measures that violate the United States’ WTO obligations, thereby giving China both standing and potentially the moral high ground to complain. And the trade remedy measures (including Section 337), along with actions under Section 301 and 232, are only applicable goods imported into the U.S. market, so they do nothing to address problems with U.S. exports to or investments in China or with Chinese investment bound for the U.S. Finally, such unilateral actions by the United States are most susceptible to the lure of a trade-off for the short-term economic gain

³⁵ 2017 USTR Report to Congress on China’s WTO Compliance at 5.

³⁶ Harry G. Broadman, “The Coalition-Based Trade Strategy Trump Should Pursue Toward China,” *Forbes*, April 9, 2018.

of additional sales of U.S. goods, agriculture and services to China in exchange for backing away from insisting on the kinds of fundamental and systemic changes that are most needed.

Among the actions against imports the United States could take:

1. Anti-dumping and countervailing duty actions – price discrimination and subsidies

There are currently 162 anti-dumping (AD) or countervailing duty (CVD) orders in place for imports of various products from China (113 AD and 49 CVD). In addition to the 162 orders already in place, there are a dozen cases pending, including one case on aluminum sheet that was initiated by the Commerce Department, rather than the domestic industry.

Anti-dumping orders result in additional duties being applied to all future imports of the particular product involved in the investigation to compensate for the amount of “dumping”, determined by comparing the “normal value” (usually the home market price) of the goods to the export price for the same goods. Countervailing duties, on the other hand, are designed to compensate for the portion of production costs that have been effectively paid by a government subsidy. Up until March of 2007, the U.S. (and a number of other countries) did not apply the CVD laws to China, on the theory that in China, a non-market economy, pervasive state control made it impossible to establish an effective benchmark against which the Department of Commerce could measure whether a particular government action created a countervailable subsidy. But since the reversal of that presumption, most complaints against China have involved allegations of and ultimately the application of both AD and CVD duties. Given the level of subsidies being provided to many Chinese producers, a number of the CVDs are set at very high rates—rates high enough to preclude most imports.

The benefit of AD and CVD cases is, assuming correct procedures, they are permitted under the WTO rules and more tailored to the express concerns of U.S. producers about imports of a particular product. The downside is that they do not address the more systemic concerns and often have the effect of simply pushing imports out of the U.S. market and into third-country markets, thereby creating additional problems for our trading partners.

2. Safeguards

Safeguards are also permitted under the rules of the WTO and allow the imposition of tariffs or quotas on imports if there is evidence that a surge in imports has caused serious injury to the U.S. domestic industry making the same product. The downside of using safeguards to address problems in China is that they are not targeted—safeguards are supposed to be applied to imports from the entire world, with no exceptions. So safeguards are likely to harm our allies more than China and, like AD and CVD duties, are only applicable to goods being imported into the U.S.

3. Section 337 – intellectual property rights

Under Section 337 of the Tariff Act of 1930, imports into the U.S. can be banned if those imports either violate U.S. intellectual property (IP) rights or involve “unfair methods of competition and unfair acts” that cause harm to a U.S. industry. The vast majority of all cases heard to date involve claims of patent infringement. Like AD and CVD cases, Section 337 cases normally involve a petition by the U.S. holder of patent (or other IP right) contending that imports are infringing those IP rights. The quasi-judicial independent agency, the U.S. International Trade Commission (USITC), hears the cases, determining both whether the IP right is valid and whether the imports infringe it and if so, the USITC recommends a remedy to the President, which can include cease and desist orders and a ban on future imports.

Additional Section 337 cases may be one viable option to combat Chinese IP theft, provided the IP is embedded in goods destined for the U.S. market. Likely targets are Chinese imports that infringe U.S. IP rights, particularly trademarks and higher-tech patented items. The benefit of such actions is that they are enforced by U.S. Customs and Border Patrol (Customs), so are designed to have the effect of stopping goods at the border. The downside for trade mark infringement may be the difficulty of enforcing orders for goods shipped in by mail or in small lots that are not routinely scrutinized by Customs. The downside for patents may be the time and expense of proving patent validity and patent infringement in the fast moving high-tech space.

4. Section 232 – National security

As we have seen from the recent decision by the Trump Administration to impose 25% tariffs on steel imports and 10% on aluminum (and to open an investigation into imports of cars, SUVs and parts), Section 232 of the Trade Expansion Act of 1962 gives the President the power to impose tariffs or quotas on imports if he concurs with a determination by the Commerce Department that imports of a given product are a threat to the national security of the United States. The idea behind Section 232 is to give the president broad power to ensure that the U.S. is not overly dependent on imports for critical defense needs, particularly when those imports are coming from countries we don't trust to supply us in times of war. U.S. law also includes a nod to the impact of foreign competition on the economic welfare of U.S. industries.

The problems with reliance on Section 232 are myriad. First, it too only applies to imported goods coming in to the U.S. market, so while it can be used to stop goods from China, it won't address the more systemic problems or those of concern to U.S. investors in China. Second, given that the definition of national security under 232 is broad while the definition under WTO law is limited to trade in nuclear materials, or arms and ammunition or actions taken during a time of war, there is a high likelihood that any U.S. actions taken under Section 232 will violate the WTO and give ground for our trading partners to retaliate against any U.S. tariffs or quotas. Unlike safeguards, however, actions under Section 232 could be targeted at just goods from China and not others, narrowing the scope for retaliation. Like AD and CVD actions, Section 232 duties will have the side-effect of diverting exports from the U.S. market to third-country markets.

5. Section 301 – violations or unreasonable or discriminatory actions

Section 301 of the Trade Act of 1974 allows USTR to determine that a foreign country is denying the United States its rights under a trade agreement or is carrying out practices that are unjustifiable, unreasonable or discriminatory and burden or restrict U.S. commerce. Once USTR makes such a determination, the President can take various retaliatory actions, including the imposition of duties or other import restrictions. The actions can be taken against whatever imports from whatever sources are subject to the USTR determination. As with the other actions noted above, the remedies under Section 301 are limited to actions against imports coming into the U.S. market. In addition, as a result of a successful challenge by the EU at the WTO, the U.S. agreed not to unilaterally invoke Section 301 unless the WTO dispute settlement system had determined that the United States' rights had indeed been violated.

As discussed above, in August of 2017, an investigation was initiated into the policies and practices of China relating to technology transfer, intellectual property and innovation. This is the first time since the establishment of the WTO that unilateral action under this provision has been taken. As a result of the USTR determination, President Trump has indicated: a) an intention to imposed tariffs on \$50 billion of Chinese imports, with the definitive list of the products to be subjected to the tariffs announced on June 15, 2018; b) an intention to impose investment restrictions on investments from China, with the specifics of such restrictions to be announced soon; and c) the filing on March 26 of a new WTO case claiming

violations of the national treatment and certain patent provisions of the TRIPs Agreement. In this Section 301 investigation, the U.S. did not first complain about these particular Chinese policies at the WTO or receive WTO authorization to impose these measures. China has challenged the possible 301 tariffs as a violation of the United States' tariffs commitments, its MFN commitment and the rules of the dispute settlement system. The U.S. maintains that generally, the policies under investigation are not covered by WTO agreements and therefore the United States is not required to litigate these issues at the WTO.

In addition to these five actions against imports into the U.S. market, there are two broader actions that also could be taken:

1. International Emergency Economic Powers Act (IEEPA)

The International Emergency Economic Powers Act of 1977 authorizes the President to regulate commerce after declaring a national emergency in response to any foreign-sourced unusual and extraordinary threat to the United States.

Under IEEPA, the President can “regulate” all forms of international commerce, with “regulate” having been determined to include raising tariffs. IEEPA also authorizes the President to block transactions and freeze assets. In the event of an actual attack on the United States, the President can also confiscate property connected with a country, group, or person that aided in the attack.

2. Trading with the Enemy Act (TWEA)

The broadest of all presidential powers over international trade and investment is the Trading with Enemy Act of 1917. It delegates to the President broad powers to regulate all forms of international commerce and to freeze and seize foreign assets if such actions are taken “during the time of war.” While there is no specific authorization to raise tariffs or impose quotas, the U.S. Court of Customs and Patent Appeals held that President Richard Nixon’s 10% surcharge on all imports fell within the parameters of “regulating” commerce. It is not clear whether TWEA would give the President the authority to take action against China, given the absence of a war. However, other actions have been taken many decades after the end of a given war.

Finally, beyond the realm of actions against imports, there are a few specific actions affecting investments and exports controls:

1. Committee on Foreign Investment in the United States (CFIUS)

CFIUS is an interagency group established by executive order in 1975 that is responsible for advising the president on how foreign investment affects the U.S. It consists of the heads of 16 departments and agencies and is chaired by the Secretary of the Treasury. Among other things, it is responsible for ensuring that foreign direct investment does not negatively impact U.S. national security.

The latest use of CFIUS was to halt Broadcom Ltd.’s (a Singapore company’s) \$117 billion hostile bid for Qualcomm Inc., a U.S. producer of mobile telecommunications equipment. The concern was that Broadcom would stymie research and development at Qualcomm. CFIUS indicated that such a move could weaken Qualcomm – and thereby the U.S. – against foreign rivals racing to develop next-generation wireless technology known as 5G, such as China’s Huawei Technologies Co.

The Congress has been considering legislation to expand the reach and scope of CFIUS, with proposals to potentially include joint ventures (which would mean review of outbound U.S. investment in China), but at their markups last week, both the Senate Banking Committee and the House Financial Services Committee removed the joint venture language. The CFIUS reforms would likely particularly

affect mergers and acquisitions along with early investment by Chinese entities in high-tech, telecommunications and big data industries.

2. Export controls

The final area for potential action affecting China is export controls. The U.S. Departments of State, Commerce, Homeland Security, Treasury, Defense, and Energy each play a critical role in export control and nonproliferation activities both within the United States and outside its borders. Limiting the ability of U.S. companies to export sensitive technology to China is one additional tool in the tool-box for addressing the concerns about too much sensitive technology being transferred to China.

G. Conclusion

The answer to the question embedded in the title of this hearing – U.S. tools to address Chinese Market Distortions – is that the single best tool that the United States has is its membership in the WTO and its ability to bring together like-minded countries to challenge China’s commitments to and membership in the WTO. I urge this Commission to recommend that the United States pick up that tool and pull together a coalition-of-the-concerned to bring a bold and comprehensive challenge to China’s economic system and its persistent violations of its WTO. Such a case should include the many specific claims of violation that I have outlined in my testimony, but should also include the “exceptional” claim of a non-violation nullification and impairment of the legitimate expectations that the United States and others had when China joined the WTO. It should have as its goal both specific rulings with which China will need to comply but also sparking negotiations to improve the rules of the WTO where they have failed.

While the United States has other domestic tools at its disposal, all of them suffer by comparison. All involve unilateral action that will not be big enough to bring about the kind of real systemic change that is needed. Virtually all of them would also violate the United States’ WTO obligations and would invite retaliation. All would be focused on Chinese imports to the United States rather than on practices in China.

The concerns with China are global concerns. The tools used to address the concerns and the solution sought should be global as well.

Appendix A

DISCLAIMER: The U.S. delegation is providing the below draft framework solely to help facilitate candid and constructive exchanges between the two sides. The current text is not a proposed international agreement and remains subject to ongoing review. In the interest of time and out of respect for the seriousness of the issues that the two sides will discuss, this document is being provided in advance of the visit and while this review is ongoing.

The U.S. delegation looks forward to discussing this draft and related issues later this week in Beijing.

BALANCING THE TRADE RELATIONSHIP

between

THE UNITED STATES OF AMERICA AND THE PEOPLE'S REPUBLIC OF CHINA

The Government of the United States of America ("United States") and the Government of the People's Republic of China ("China") have strong overlapping interests as the world's two largest economies and the major drivers of global growth. At present, the United States-China trade relationship is significantly imbalanced. United States investment and the sale of services into China remain severely constrained. China's industrial policies now targeting U.S. technologies and intellectual property pose significant economic and security concerns to the United States.

There is an immediate need for the United States and China to reduce the U.S. trade deficit with China by ensuring that China's market is open to United States traders and investors on a fair and non-discriminatory basis. China therefore undertakes to (a) eliminate improper tariff and non-tariff barriers to United States exports to China, (b) address China's policies and practices related to technology transfer and intellectual property, (c) treat United States service providers in China on terms equal to those provided to Chinese service providers in the United States, and (d) record China's agreement not to target United States farmers and agricultural products. To address these issues and restore balance in the United States-China trade relationship, there is an immediate need for the United States and China to agree on a set of concrete and verifiable actions.

SECTION 1

TRADE DEFICIT REDUCTION

China commits to work with Chinese importers to engage in trade transactions to achieve targets to which the Parties agree. These transactions are specifically designed to reduce the United States-China trade deficit by \$100 billion in the twelve (12) months beginning June 1, 2018, and an additional \$100 billion in the twelve (12) months beginning June 1, 2019, such that the U.S. trade deficit with China will have decreased compared to 2018 by at least \$200 billion by the end of 2020. China's purchase of U.S. goods will represent at least 75% of China's commitment to a \$100 billion increase in purchases of U.S. exports for the twelve months beginning June 1, 2018, and at least 50% of China's commitment to an additional \$100 billion increase in purchases of U.S. exports in the twelve (12) months beginning June 1, 2019.

SECTION 2

PROTECTION OF AMERICAN TECHNOLOGY AND INTELLECTUAL PROPERTY

In order to address China's policies, laws, regulations, practices and actions that are harming United States intellectual property rights, innovation and technology development, China commits as follows:

- (a) China immediately will cease providing market-distorting subsidies and other types of government support that can contribute to the creation or maintenance of excess capacity in the industries targeted by the Made in China 2025 industrial plan;
- (b) by January 1, 2019, China will eliminate specified policies and practices with respect to technology transfer;
- (c) China will take immediate, verifiable steps to ensure the cessation of Chinese government-conducted, Chinese government-sponsored, and Chinese government-tolerated cyber intrusions into U.S. commercial networks and cyber-enabled theft targeting intellectual property, trade secrets and confidential business information held by U.S. companies;
- (d) China will strengthen specified intellectual property rights protection and enforcement;
- (e) by January 1, 2019, China will eliminate the provisions of the Regulations on the Administration of the Import and Export of Technologies and the Regulations on the Implementation of the Law on Chinese-Foreign Equity Joint Ventures identified in the U.S. request for WTO consultations in *China – Certain Measures Concerning the Protection of Intellectual Property Rights* (DS542); and
- (f) by July 1, 2018, China will withdraw its request for WTO consultations in *United States – Tariff Measures on Certain Goods from China* (DS543) and will take no further action related to this matter under the WTO Understanding on Rules and Procedures Governing the Settlement of Disputes (“DSU”).

In addition, China will not take any retaliatory action, whether in the form of tariffs on imports of U.S. products or in any other form, including unwarranted sanitary and phytosanitary (“SPS”) measures, unwarranted technical barriers to trade (“TBT”) measures, antidumping and countervailing duties, and discriminatory inspection, quarantine and testing practices directed at imports of U.S. agricultural products, in response to actions taken or to be taken by the United States, including any new U.S. restrictions on investments or imports. China immediately will cease all retaliatory actions currently being pursued.

China agrees to immediately cease the targeting of American technology and intellectual property through cyber operations, economic espionage, counterfeiting, and piracy. China also agrees to abide by U.S. export control laws.

SECTION 3

RESTRICTIONS ON INVESTMENT IN SENSITIVE TECHNOLOGY

In light of China's prevailing investment restrictions and state-directed investment in sensitive U.S. technology sectors, including industrial plans such as Made in China 2025, China confirms that it will not oppose, challenge, or otherwise retaliate against the United States' imposition of restrictions on investments from China in sensitive U.S. technology sectors or sectors critical to U.S. national security.

SECTION 4

UNITED STATES INVESTMENT IN CHINA

China recognizes that China should not distort trade through investment restrictions, and that any investment restrictions or conditions imposed by China must be narrow and transparent. U.S. investors in China must be afforded fair, effective and non-discriminatory market access and treatment, including removal of the application of foreign investment restrictions and foreign ownership/shareholding requirements. In furtherance of these principles, China will issue an improved nationwide negative list for foreign investment by July 1, 2018. Within ninety (90) days of the date on which China issues this negative list, the United States will identify existing investment restrictions that deny U.S. investors fair, effective and non-discriminatory market access and treatment. Following receipt of the U.S. list of identified restrictions, China is to act expeditiously to remove all identified investment restrictions on a timetable to be decided by the United States and China.

SECTION 5

TARIFF AND NON-TARIFF BARRIERS

China's tariffs and non-tariff barriers are significantly higher than those of the United States for most tradable goods. China commits to address U.S. concerns relating to tariffs and non-tariff barriers as follows:

- (a) by July 1, 2020, China will reduce its tariffs on all products in non-critical sectors to levels that are no higher than the levels of the United States' corresponding tariffs; and
- (b) China will remove specified non-tariff barriers.

China also recognizes that the United States may impose import restrictions and tariffs on products in critical sectors, including sectors identified in the Made in China 2025 industrial plan.

SECTION 6

UNITED STATES SERVICES AND SERVICES SUPPLIERS

In order to achieve fair treatment with respect to U.S. services and services suppliers, China commits to improve access to its market in specified ways.

SECTION 7

UNITED STATES AGRICULTURAL PRODUCTS

In order to achieve fair treatment with respect to U.S. agricultural products, China commits to improve access to its market in specified ways.

SECTION 8

IMPLEMENTATION

China and the United States will meet quarterly to review progress in meeting agreed targets and reforms.

In the event that the United States considers that China fails to comply with any of China's commitments in this Framework, including deficit targets, China acknowledges the likelihood that the United States will impose additional tariffs or other import restrictions on Chinese products, or on the supply of services or investment, to such extent as the United States deems appropriate. China also understands that it will not oppose, challenge or take any form of action against the United States' imposition of additional tariffs or restrictions pursuant to this paragraph, including action pursuant to the DSU.

China will withdraw its WTO complaints regarding designations of China as a non-market economy by the United States and European Union (*United States – Measures Related to Price Comparison Methodologies* (DS515), *European Union – Measures Related to Price Comparison Methodologies* (DS516)) and will refrain from challenging the treatment of China as a non-market economy under the DSU in the future.

Additionally, within 15 days of receiving written notice of a prohibited product that may have been transshipped through one or more countries, with or without modification, China will provide full details of every such shipment to the suspected destination or destinations. If China fails to do so, or the information reveals that transshipping is occurring, the United States will impose tariffs equal to the amount of suspected transshipments.

China understands that if it fails to uphold any commitment under this Framework for Discussion, it is likely that the United States will impose tariffs on imports from China, and, where appropriate in the case of China's commitments under subsection (c) of Section 2 or the last paragraph in Section 2, U.S. Customs and Border Protection will confiscate counterfeit and pirated goods or levy tariffs to compensate the United States for its lost technologies and intellectual property. China commits to not take any retaliatory action in response to the imposition of tariffs or confiscations by the United States pursuant to this Section.