Is China Playing By the Rules? Free Trade, Fair Trade, and WTO Compliance
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Statement for the Record
The Hon. Sander M. Levin

Today's hearing is called, "Is China Playing by the Rules?" The answer to that question is clearly and unfortunately, "No." China has not yet come into full compliance with its WTO commitments. I am not talking about the commitments that China's WTO agreement allows it to phase in; I am speaking of the commitments China agreed to fully implement either immediately or within its first two years of WTO accession. China has not yet fulfilled many of these commitments; in other cases, China has taken steps that indicate a clear intention to undermine its WTO market access commitments.

In many areas, China has made substantial progress and it is important to acknowledge that progress. At the same time, halting progress is not what the U.S. bargained so hard for. The United States is fully living up to its WTO commitments vis-a-vis China - evidenced by total Chinese imports to the United States of $125 billion. The massive trade deficit with China of over $100 billion - the single largest U.S. bilateral trade deficit - reminds us that we cannot be satisfied with mere "progress" from China. We need complete, unconditional, and timely compliance from China with its WTO commitments.

Last year, many in Congress, the business community and the Administration were willing to take a "pressure and patience" approach, giving China time to make all the myriad changes to law and practice necessitated by WTO accession. Indeed, we still must realize the massive re-structuring that China's legal system, even China's society, is undergoing by virtue of China's membership in the WTO. Had China made concerted, uninterrupted, and steady progress toward WTO compliance, that approach may have continued.

Unfortunately, the Chinese government's lack of attention to the rule of law has infected its approach to WTO compliance. The Chinese government has often taken arbitrary and inconsistent approaches to its WTO obligations; it has acted in non-transparent ways and refused to publish the laws and regulations with which businesses must comply; in some cases, the Chinese government has retained for itself a large measure of discretion, creating an uncertain environment and leaving companies unclear as to what the rules are.

Moreover, China has blocked effective use of the specially-negotiated annual Transitional Review Mechanism (TRM) of China's WTO compliance. In most cases, China has refused to provide written answers to questions submitted by other WTO Members; in many other cases China has refused to provide any answers or given vague and evasive answers. China has denied consensus on efforts to make the TRM process more effective and has even gone so far as to call countries that raised concerns about China's WTO compliance "troublemakers," reminiscent of language China uses in the domestic context to silence dissent.

Listed below are just some of the continuing problems with China's WTO accession:

- **Transparency**. Article X of the WTO requires countries to publish in advance all laws, regulations, etc. affecting the import, sale, distribution, transportation, insurance, warehousing, inspection, etc. of imports. China has made some progress, but still does not uniformly publish laws and regulations applicable to trade, meaning U.S. firms often do not know what the rules are, whether the rules have changed, or how to comply with the rules.

- **Additionally**, even when China does publish regulations, these are often very vague and leave government authorities wide discretion, which is applied in an unpredictable manner and in ways preferential to Chinese-based manufacturers.

- **Quota Administration and Import Licensing**. China's administration of its quotas and import licensing rules has made it very difficult for companies in China to import products from the United States and for U.S. exporters to find Chinese buyers. For instance, China announced increases in quotas on automobiles and auto parts, but there is little public information on what companies received quota allocations or how those quotas may be exercised. In some cases, allegations have arisen that China has awarded import quotas in economically unviable amounts, to domestic producers of competing products or state-owned companies that have no intention of importing, and to companies that have committed to use the import only as an input for products to exported.

- **Discriminatory taxes**. China continues to impose discriminatory taxing schemes on various "border trade" products and other products, including integrated circuit products. The former clearly violates MFN and the latter clearly violates China's national treatment obligations.

- **Continuing Limits on Trading Rights**. China only allows some companies to import and export products ("trading rights"). China strictly controls which companies have such rights, and uses this control as a tool to restrict imports. China agreed to broaden trading rights, but it has not yet implemented its commitments and appears to be imposing new conditions on these rights.br>
- **Distribution Rights**. Even if U.S. products are imported via trading rights, China imposes limits on who may distribute products. China uses these distribution rights as a way of keeping out U.S. imports. China is obligated by its WTO commitments to expand distribution rights, but has failed to take all the steps necessary to do this.

- **Intellectual Property**. Intellectual property piracy is rampant throughout China. China has made progress to improve its legal framework, but continues to have a poor record of enforcement, suggesting a lack of will from the government.

- **Technical Barriers to Imports**. In some sectors China has issued new technical product and safety regulations that are sui generis and appear to be designed to help keep out imports.

- **Currency Undervaluation**. Article XV(4) of the GATT prohibits WTO members from using "exchange action" to "frustrate the intent of the [GATT] provisions." China has allowed kept its currency pegged to the dollar at a rate that economists agree is substantially undervalued, effectively providing a "currency tariff" on U.S. exports to China and a "currency subsidy" to Chinese imports to the United States.

- **Auto Financing and Other Financial Services Limited by Unreasonably High Capital Requirements**. China agreed to open its auto financing market to U.S. firms upon its WTO accession. Two years later, China has not complied with this obligation. Its draft regulations contained unreasonably high capital requirements that are not justified by any prudential or regulatory rationale and it has yet to issue final regulations. Other U.S. financial services providers face similar market access barriers.

- **Auto Industrial Policy Paper**. In April of this year, China issued a draft "Development Policy for Auto Industry" setting forth Chinese government industrial policy for the automotive industry. This paper is admittedly light on specifics, but the following concepts in the paper are or could be problematic:

  - Mentions "macroeconomic steering" to achieve the objective of becoming "one of the major automobile manufacturing countries in the world by 2010."
  - Indicates numerous points in which the state will standard-less control over competitive decisions of automobile manufacturers in China through various approval mechanisms, which could be used as way of forcing technology transfer or limiting allowable imports.
  - Includes plans to restrict the number of ports through which imported autos may enter.
  - Requires that imported and domestically-produced autos be distributed through separate sales outlets.
  - Sets export targets of components and parts of 40% by 2010.
  - Suggests that technical requirements will be used as a way of keeping out imports and simple assembly operations.
  - Indicates that the state will provide subsidies for the development of auto electronics.
  - Dangles for foreign firms the possibility of a "strategic alliance" with a domestic firm that would have 10% market share in exchange for technology and know-how transfer.
  - Suggests availability of state-subsidized capital for the domestic auto industry.
  - Indicates firms will have to produce domestically in China at least five years before they can enter new product lines or open new factories in other cities.
  - Indicates that preferential treatment will be given to plants set up for export.
  - Indicates that state subsidies will be provided to develop stronger domestic steel plate for autos manufacturing capacity and machine tools and dies.
  - Sets goal that Chinese companies will provide designs for half of all domestically produced cars by 2010.
  - Indicates that quotas and creative application of customs duties will be used to keep out auto part imports.

Compliance with WTO obligations cannot be a one-way street. It is time for the USTR to take the lead and aggressively demand China's complete, unconditional, and timely compliance with all of its WTO commitments. USTR must use every avenue to push China to come into compliance with its WTO obligations. Last year, the USTR allowed China to block effective use of the TRM, and it looks as if this year, USTR is resigned to accept continuing uncooperativeness by China as a fact of life. The TRM was designed to help avoid larger confrontations over China's WTO compliance. If China continues to defy the WTO and frustrate the TRM process, USTR should begin a campaign of cases against China in WTO dispute settlement.

American manufacturers are justifiably concerned that Chinese imports have free access to our market, while China has refused to open its market more fully to U.S. goods. It is time to start taking concrete action to remedy the imbalance.