Is China Playing By the Rules? Free Trade, Fair Trade, and WTO Compliance
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Statement of
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Thank you for inviting me to appear before you today to discuss the Administration's perspectives on the United States' trade relationship with the People's Republic of China and, in particular, the topic of China's WTO implementation.

China's Implementation of its WTO commitments

China acceded to the WTO on December 11, 2001, after 15 years of negotiation with the United States and other members of the WTO and its antecedent, the General Agreement on Tariffs and Trade. China's accession was a watershed event for both China and the United States. By committing to implement the WTO's market access, national treatment and transparency standards; protect intellectual property rights; and limit the use of trade-distorting domestic subsidies, China promised to deepen and consolidate the market-oriented economic reforms first initiated in the years following the death of Mao Zedong. For the United States, China's WTO accession not only promised unprecedented market access to one of the world's most intriguing, and fastest growing, economies; it also provided a forum through which the United States and China could mediate and resolve trade disputes without the use of unilateral measures. At its heart, China's WTO accession represents a commitment by China to play by the established rules of international trade both at the border and internally, and thus was a fundamental step toward establishing the primacy of the rule of law in China.

China has now been a WTO member for more than 21 months. In that time China has completed much of the nuts-and-bolts work of WTO implementation: amending and promulgating thousands of laws and regulations to effect its WTO commitments, establishing new transparency procedures in many national and sub-national agencies, and reducing tariffs to their committed levels. This work has taken place against a challenging political and social backdrop: since December 2001 China underwent a major leadership change; passed through a harrowing national SARS epidemic; faced unprecedented protests by some 600,000 Hong Kong citizens; and generally has confronted the host of dislocations inherent in its transition from a planned to a more market-oriented economy.

Whether or not China's domestic difficulties have had an impact on its ability to implement its WTO commitments in both letter and spirit, the Administration has noted a variety of shortcomings in WTO implementation over the course of the past 21 months. As highlighted in our 2002 Report to Congress on China's WTO Compliance, covering China's first year of WTO membership, China's WTO implementation was most problematic in the areas of agriculture, services, enforcement of intellectual property rights and transparency. Although we have seen progress in some of these areas, they still remain areas of serious concern. At the same time, other areas of concern have begun to emerge. For example, China's use of certain tax policies to favor domestic production or provide incentives to increase exports has developed into a significant source of concern. In some sectors that the Administration has engaged with China and resolved WTO trade-related concerns, new problems have emerged in place of those resolved through engagement.

In our experience, China's compliance problems are occasionally generated by a lack of coordination among relevant ministries in the Chinese government. Another source of compliance problems has been a lack of effective or uniform application of China's WTO commitments at local and provincial levels. China is taking steps to address both of these concerns, through more effective inter-ministerial mechanisms at the national level, and through a more concerted effort to reinforce the importance of WTO-consistency with sub-national authorities. In other cases, however, compliance problems involve entrenched domestic Chinese interests that may be seeking to minimize their exposure to foreign competition. These problems are difficult to deal with, and even after the Administration has engaged with China and resolved our concerns, new problems have often emerged in place of those resolved through engagement.

The central lesson the Administration has learned with respect to China’s WTO implementation is that the years of tough negotiations that led up to China’s WTO accession were no accident. We will need to match the painstaking efforts and persistence of those negotiators in order to ensure that China implements its commitments fully. While providing an exhaustive inventory of bilateral trade concerns is beyond the scope of this statement, I would propose to highlight a number of central concerns and the ongoing efforts of the Administration in pursuing their resolution.

Agriculture

China’s potential as a market for U.S. exports of bulk agricultural commodities was a key factor in U.S. support for China’s WTO accession and grant of Permanent Normal Trade Relations (PNTR) status to China. While bumper harvests of some crops in China in 2002 may have limited the commercial potential of some U.S. exports, China’s attempts to restrict certain agricultural imports has been an ongoing theme of the first 21 months since China’s WTO accession. The use of – or even the threat to use – questionable GMO standards and sanitary and phytosanitary (SPS) measures to restrict imports of some products for alleged health and safety concerns has frustrated efforts of U.S. agriculture traders, most notably in the case of soybeans. In the case of those bulk agricultural commodities subject to negotiated tariff-rate quotas (TRQs) in China, the setting of sub-quotas, use of Catch-22 import licensing procedures, allocation of TRQs in commercially unviable quantities and a lack of transparency in TRQ allocation and management have combined to disturb what should be a ready market for U.S. exporters, particularly in the case of cotton.

After the efforts of Ambassador Zoellick, Agriculture Secretary Veneman and others in the Administration, the commercial impact of these potential barriers was contained. U.S. exports of soybeans topped $1.2 billion – a record – and cotton sales were already 8-10 times greater than in any previous calendar year by July, 2003. Nevertheless, systemic problems with both GMO and SPS regulation continue to hang like a cloud over the marketplace, and a negotiated settlement to our concerns with China’s TRQ system has yet to be fully implemented. These and other emerging concerns, such as China’s apparent use of supports to promote agricultural exports, will require continued vigilance and engagement by the Administration in order to prevent a disruption in this important trade.

Intellectual Property Rights

In the year leading up to WTO accession, China did make significant improvements to its framework of laws and regulations protecting intellectual property rights (IPR). However, the lack of effective IPR enforcement in China is a major obstacle toward a meaningful system of IPR protection. IPR problems run the gamut, from rampant piracy of film and other entertainment products, to sophisticated software and semiconductor products, to counterfeiting of consumer goods, electrical equipment, automotive parts and pharmaceuticals. IPR infringements not only have an economic toll; but also present a direct challenge to China's ability to regulate those products that have health and safety implications for China's population and international purchasers of such products. While a domestic Chinese business constituency is increasingly active in promoting IPR protection for self-interested reasons, the problem is immensely widespread. If significant improvements are to be achieved on this front, China will have to devote considerable resources and political will to this problem, and there will continue to be a need for sustained efforts from the United States and other WTO members.

The United States has had an ongoing dialogue with China on IPR matters for a number of years, including through an annual series of bilateral meetings chaired by USTR and its Chinese counterpart, the Ministry of Commerce, the next series of which is scheduled for November this year. Ambassador Zoellick, Secretary Evans, and, most recently, Secretary of Treasury Snow have used every occasion to press China on the importance of a more effective regime for IPR enforcement. In the view of the Administration, the key to achieving this end will be for China to increase deterrent-level criminal penalties for IPR violators, demonstrate a willingness to increase prosecution and punishment of IPR offenders, to lower thresholds for criminal prosecution, to increase resources and devote more training for enforcement in all parts of China, and to establish more effective communication procedures between relevant officials of China's courts and investigative units, the Supreme People's Procuratorate and China's lawmaking bodies.

Services

Meanwhile, concerns arose in many services sectors, principally due to transparency problems and China's use of prudential requirements that exceed international norms. The United States and China have had reasonably cooperative talks to resolve these concerns in many of the affected sectors, but progress has been slow and not without frustrations. In some cases, such as express courier services, much progress was made toward resolving regulatory concerns in 2002, but problematic regulations remain under consideration, even if they have yet to be implemented. In other cases, such as implementation of China's commitments on branching by insurance companies, the United States and China remain at odds despite a longstanding cordial and otherwise productive dialogue with Chinese regulators.

Value-Added Tax Policies

China has increasingly used value-added tax (VAT) policies to encourage domestic industrial or agricultural production in a number of sectors. In the case of semiconductors, China's policy of providing rebates of VAT to domestic semiconductor producers disadvantages U.S. exports and raises significant WTO compliance concerns. In the case of fertilizer, China exempts from the VAT fertilizers that compete directly with the principal U.S. fertilizer export, a practice that is difficult to justify by WTO rules. In addition, we also have received reports that China has been rebating the VAT paid on domestically produced agricultural goods, including corn, and even that China is rebating the VAT in such a way as to subsidize exports – a particularly serious charge, given China's WTO commitment to eliminate export subsidies. The Administration has engaged China on all these practices, and will continue to pursue the elimination of discriminatory or trade-distorting VAT policies through appropriate channels in Beijing, Washington and Geneva.

China's WTO Transitional Review Mechanism

China was admitted to the WTO on somewhat unique terms. Rather than completing the process of implementing its WTO commitments as a pre-condition of WTO membership, China was admitted to the WTO by *committing* to implement them. In large part to monitor China's transition toward full implementation, the WTO conducts an annual review of China's implementation progress: the

Transitional Review Mechanism (TRM). This review, which will take place in eight of the next nine years in 16 subsidiary bodies as a lead-up to the year-end meeting of the WTO's General Council, is an opportunity for other WTO members to engage China on the extent to which it has complied with its commitments and to clarify China's trade practices. The first year of the TRM was marked by some misunderstanding between China and other WTO members as to expectations of China at the TRM, but communication clearly improved as the process unfolded. The Administration expects a smoother and more useful TRM in year two and beyond.

Imports

The trade imbalance between the United States and China topped $103 billion in 2002, and threatens to climb higher in 2003. I should point out that this is in part a result of the expansion of our overall trade relationship: While imports from China outpace those from all other WTO members, China is also our fastest growing export market. In 2002 our exports to China were over $22 billion, and, with exports through July 2003 up 22.7% compared with the equivalent period in 2002, China has become our 6th largest export market. Nevertheless, the rapid expansion of trade between our two countries has inevitably lead in some cases to competition between domestically produced goods and imports in both our markets. To the extent China unfairly protects its domestic producers to the detriment of competition from United States, the Administration continues to be prepared to assert U.S. interests. To the extent imports from China disrupt U.S. markets, the Administration is fully prepared to assert the rights of the United States under China's WTO accession agreement.

As part of China's WTO accession package, China agreed to two separate China-specific safeguard mechanisms to allow WTO members to cope with market disruptions caused by increasing economic integration with China, particularly during the period when China is still phasing in its WTO commitments. One such mechanism, the product-specific safeguard, was codified as Section 421 of the Trade Act of 1974, as amended, and is available until December 11, 2013. Since the implementation of Section 421, three petitions have been brought requesting import relief. In one case, the International Trade Commission found that our domestic producers' market had not been disrupted by imports from China. In two other cases, while the ITC found market disruption, the President determined that the adverse impact on the U.S. economy was clearly greater than the benefits from providing import relief. While to date no import relief has been granted under Section 421, the President, in his most recent determination, reiterated his commitment to using the safeguard when the circumstances of a particular case warrant.

The second safeguard agreed to by China as part of its WTO accession package is specific to textiles, and allows WTO members the opportunity to invoke limited import relief – specifically a 7.5% cap on growth in imports of a given textile category for up to one year (6% for wool products) – until December 31, 2008. The Administration is currently reviewing three requests under this safeguard mechanism, and initial determinations will be forthcoming in mid-November of this year.

U.S.-China Dialogue on Economic Matters

The Administration maintains three formal dialogues with Chinese ministries. The Commerce Department chairs meetings of the Joint Commission on Commerce and Trade; the Treasury conducts meetings of the Joint Economic Commission with the Chinese Ministry of Finance; and USTR chairs an interagency Trade Dialogue with counterparts from the Ministry of Commerce and relevant other Chinese agencies. Like many of the informal contacts, these formal occasions are opportunities not merely to discuss bilateral and multilateral trade and economic matters, but are themselves action-forcing events at which significant progress can be achieved. They also act as an early warning system on trade problems – providing an opportunity to resolve issues before they become broader bilateral irritants.

In addition to these formal processes, the Administration meets frequently on both the Cabinet and sub-cabinet level with senior Chinese officials, and uses such meetings to press the importance of economic issues with Chinese counterparts. In the case of USTR, Ambassador Zoellick meets or speaks via telephone with PRC Minister of Commerce Lu Fuyuan on a regular basis, has been to China twice since December 11, 2001, and plans to travel to China again for bilateral discussions next month. Ambassador Josette Sheeran Shiner recently confirmed as Deputy USTR, plans to continue an active dialogue with her counterparts, and other USTR officials meet regularly with Chinese officials on bilateral trade concerns, whether in Washington, Beijing, or at the WTO. These exchanges are critical opportunities to advance bilateral and multilateral trade and economic matters, and have proven effective in making progress on key U.S. concerns.

Conclusion

Mr. Chairman and members of the Commission, thank you for providing me with the opportunity to testify. I look forward to your questions.