The Direction of China's Trade and Industrial Policies

Testimony of

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China's industrial overcapacity issue

Industrial overcapacity had been a long-standing problem in China's economic development and uncertainty in the country's recovery from the economic slowdown, and the government has repeatedly tried to curb overcapacity in a range of sectors.

The following are major relevant cases, quotes and figures:

-- On Oct.19, China's 10 departments, including the National Development and Reform Commission and the Ministry of Industry and Information Technology (MIIT), jointly made a warning that the country's economic recovery could be hampered with chaotic expansion in certain industrial sectors, especially in steel making, cement, plate glass, coal chemical, polycrystaline silicon and wind power equipment sectors.

-- On Dec.7, China's Central Economic Work Conference (CEWC), the annual economic planning meeting, agreed at its conclusion to advance economic structure adjustment and focus on overcapacity elimination with strictly controlled lending to industries that were energy-intensive, polluting and had overcapacity.

-- On Dec. 21, Li Yizhong, Minister of Industry and Information Technology, said China would stop approving new projects in some industries involving excessive production capacities and duplicate constructions in the coming three years so as to guide healthy industrial development in the country.

Li noted that the government will raise the access thresholds for steel, cement, flat glass, and coal chemical industries for the purposes of efficient energy consumption, environmental protection, and integrated utilization of resources.

-- Wang Jian, secretary general of China Society of Macroeconomics, said in an article in the state-run magazine Liao Wang (Outlook), that China is facing more industries with overcapacity, rising from 11 industries in 2005 to 17 currently.

-- On Dec.23, China had again asked its financial institutions to help curb overcapacity in some industries with credit control last week, according to a joint statement issued by the People's Bank of China, China Banking Regulatory Commission, China Securities Regulatory Commission and China Insurance Regulatory Commission.

-- In 2008, China's crude steel production capacity reached 660 million tonnes with 58 million tonnes still under construction, while actual demand stood at only around 500 million tonnes.

The cement sector also saw huge excess capacity. Total capacity in the sector was 1.87 billion tonnes by the end of last year, but only 1.4 billion tonnes of cement was produced in 2008. By the end of September this year, another 600 million tonnes of capacity were put to use or under construction, MIIT figures show.

Xinhua, December 27, 2009

THE COST OF CHINA'S EXCESS CAPACITY

The world has changed; but China has not. China has responded to the world financial crisis with what seems to be great success. But this is an illusion. China's solution – a surge in spending on investment – will create greater excess capacity. China's high-savings, high-investment economy is costly for its people and destabilising for the world. The time for a radical reform is long past.

In a disturbing new report, the European Chamber of Commerce in China lays out the challenge in six sectors: aluminium, where the capacity utilisation rate is forecast to be 67 per cent in 2009; wind power, on 70 per cent; steel, on 72 per cent; cement, on 78 per cent; chemicals, on 80 per cent; and refining, on 85 per cent. Yet vast additional capacity is on the way.

The scale of the excess capacity is breathtaking. At the end of 2008, China's steel capacity was 660m tons against demand of 470m tons. This difference is much the same as the European Union's total output. Yet, notes the report, "there are currently 58m tonnes of new capacity under construction in China". To the extent that gross domestic product is driven by such absurd spending is a measure of waste, not of economic welfare.

Foreign producers fear the impact of China's growing surplus capacity on their markets. But this is not just a problem for specific industries. It is a broader problem. China has become hooked on an unbalanced pattern of economic development, in which investment cures this year's excess capacity by increasing next year's.

In China's current development model, household income is taxed, to support corporate profits. Corporations now generate more than half of China's huge savings. Since consumption tends to grow more slowly than GDP, excess capacity can only be used up via yet more investment or exports. This year, economic crisis has made the latter impossible. But China desperately needs to expand its exports once again. The result may well be a crisis in the trading system.

China's trading partners have to engage with the rising giant. They must explain that they cannot – and will not – absorb the surplus capacity its heavily distorted model of development is creating. But they can point out that this pattern also damages the standards of living of ordinary Chinese. China has to shift income from its corporations to its households and spending from investment to consumption. What is needed for that is a massive structural reform. This must start now. Indeed, it may already be too late.

Financial Times, November 29 2009

Mr. Chairman, Members of the Committee. It is a pleasure to be back before this Committee. This is a very important subject, and I appreciate the opportunity to testify.

Trade and industrial policies are intimately linked. Very often restrictions are placed on imports to assist the development of a domestic industry. Whether they are or not, industrial policy will change trade patterns as the promotion of new industries and competitors causes them to emerge and begin to export in quantity. The combination of trade measures and industrial policy often results in the creation of excess capacity. We know all too well that free markets overshoot, consumers and producers are over-confident and then lack confidence, sometimes with very wide swings in what we call the business cycle. Government intervention in the name of industrial policy can create even greater distortions, but concentrated by sector. The effects can be dramatic and harmful to the economies of trading partners of the countries engaging heavily in industrial policy.

The promotion of industry in general can also be very positive, depending on the nature of the measures used and the degree of government intervention. We applaud an emphasis on math, engineering and science in education, hoping that this results in innovation. For some of the same reasons, government backing of university R&D is welcomed. We support protection of intellectual property, which is another form of government intervention in the market. These measures are considered broadly beneficial to society, and we favor these policies at home and abroad. We are relatively tolerant of locational subsidies. If a state wishes to attract industry and gives tax holidays, that is acceptable here and accepted when practiced abroad. But at some point the greater the interventions, the more market-distorting, the measures become unacceptable to a country's trading partners.

Whenever a major new economic power appears in world trade, there are dislocations. This was true of the United States flooding England with low-priced grain in the mid-nineteenth century, was true of the formation of the Common market and the rise of industrial Japan in the last third of the 20th century in terms of their impact respectively, and is true of China's emergence as the world's largest exporting country, a country with an enormous and growing trade surplus, which has averaged over $200 billion a year from 2005 to 2009.[1] Changes in trade patterns were bound to occur and be particularly dramatic as the effects of adding an enormous workforce brought to bear on international competition in a world in which communications have become instantaneous and transportation has ceased to be as important a barrier.

When the sectoral effects of industrial policies that distort trade are added, the promotional measures of any major trading nation deserve serious attention.

The United States and the other trading nations welcomed China's entry into the WTO. But it needs to be remembered that WTO rules are not domestic law for any

[1] China's current account surplus reached over $400 billion in 2008, almost 10% of GDP (Figure 1). There is no reason to assume that the recession will change the trend.

member, nor do they cover all national measures. The functioning of an open world trading system depends ultimately on the conduct of each WTO member, and China being the largest exporter, and third largest importer in the world, its performance is of the highest importance. The question posed by the Committee in this hearing is exactly the right one: Is the direction of Chinese trade and industrial policies changing? There are signs that this is occurring.

We are familiar in the relatively recent past with another example of state developmental capitalism. Japan intervened in many of its industries through the use of some or all of the following measures: the granting of subsidies, affording home market protection, awarding preferential procurement contracts, employing national (as opposed to international) standards, coordinating the efforts of its producers, and removing the threat of anti-trust (competition law) enforcement. The result was often the substantial misallocation of resources at home, the build up of over-capacity, and the likelihood of extensive dumping abroad with consequent injury to foreign producers and their workers. With Japan, this occurred most notably with color televisions, semiconductors and steel. In the case of color televisions, the U.S. response was too little and too late and the industry was lost[2]. In the case of semiconductors, large-scale market intervention brought about a vast overproduction of computer memory chips (DRAMs) in Japan in the 1980s, but the U.S. trade and domestic policy responses were ultimately also extensive and the U.S. industry was saved[3]. The largest producer of DRAMs in Japan today is Micron Technologies, a company from Boise Idaho. With steel, the final chapter has not been written. The problem was global and not just caused solely by Japan; although Japan was a leader in distorting world trade patterns to the serious detriment of the U.S. industry[4].

Japanese automobile producers developed within a tightly sealed home market and built very substantial export capability. The ultimate U.S. response was blunt -- threatened U.S. import quota legislation. As a result, the largest Japanese auto companies

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[2] The color TV antidumping case was Treasury's swan-song in trade remedy administration. The attempt to assess duties was seriously flawed. There was a safeguard relief imposing quotas for a time, but the industry could not be saved.

[3] The response to the semiconductor problem of very restricted access to the Japanese market and dumping in all markets was to enter into an agreement under which Japanese procurement of foreign semiconductors would rise above the level that could be accounted for by purchases by the large Japanese vertically integrated electronics companies that were also the major Japanese producers of semiconductors (with a goal set of at least 20% foreign procurement) and requiring an absence of sales below cost in any market, with monitoring mechanisms to assure compliance. This was combined with renewal of the generally available R & D tax credit, revision of the antitrust laws applicable to joint research, formation of SEMATECH (the Semiconductor Technology Manufacturing Initiative) and the Semiconductor Research Corporation (SRC, which gave grants to fund university research). No incidentally the U.S.-Japan Semiconductor Agreement did not benefit the U.S. industry alone, the European industry benefited as did the nascent industries of Taiwan and South Korea. Japan’s measures are described in *The Microelectronics Race: The Impact Of Government Policy On International Competition, Government Intervention And Steel's Structural Crisis;* Westview Press, 1988.

[4] For a description of Japan’s extensive role in a system of domestic and international cartels, see *Steel and the State,* Westview Press, 1988.

made substantial investments in transplant production in the United States. An equilibrium was reached. A Japanese producer, Toyota, has the largest market share in the United States. A regrettable but unavoidable conclusion is that actual and threatened trade measures used to counter industrial policy brought about a more market-based result.

China, although having an even more overt role in controlling its economy through State-owned enterprises (SOEs) and a plethora of restrictions on trade and investment, decided on a different path to economic development than Japan took. The Japanese government had for decades prevented inward foreign direct investment. While still strongly supporting domestic champions, in 1978 Deng Xiaoping decided to open the Chinese market both to foreign investment and trade. Foreign investment was to be a source both of capital and innovative technologies. With respect to trade, a bilateral trade agreement was entered into between the United States and China in 1979 substantially reducing tariffs. This spurred greater foreign investment which entered China in ever increasing amounts annually. The companies making the investments used China as an export platform in many cases, but probably all aspired to serve the prospectively huge domestic Chinese market. In 2001 China joined the WTO. In doing so, China made a much more extensive number of specific market liberalizing commitments than had ever been made by any acceding member[5], and began to transform its economy. Foreign investment continued to pour in, and trade expanded greatly – as did China's trade surplus, which grew increased from $23 billion the year China joined the WTO to almost $300 billion by 2008[6].

Chinese industrial policies have produced immense amounts of overcapacity in a number of industries at present, even though China has a vastly larger home market than did Japan.

- The increase in China's steelmaking capacity in the last few years is enough to satisfy all demand for steel in either the United States or the European Union. -- For one high end steel product -- oil country tubular goods (OCTG) -- the ratio of domestic capacity to domestic demand is over 40 to1.

- In 2008, China became the largest producer of solar panels in the world, shipping roughly one-third of worldwide total PV cell shipments. Domestic Chinese demand accounts for only a miniscule portion of China's production.

- Chinese government officials have expressed concern about overcapacity in the production of wind energy generating equipment.

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[5] See Annex A.

[6] The trade surplus for May, 2010, totaled $19.5 billion. China's trade surplus for 2009 was $196 billion, falling 34% from the 2008 level of about $296 billion. The U.S. goods trade deficit with China was $268 billion in 2008.

- One estimate is that China will have excess capacity of 3 million automobiles per year by 2012.[7]

The series of sectors that China has targeted for special development efforts, key projects outlined in the Medium and Long-Term Science and Technology Program[8], 2006-2020, is very impressive:

- core electronic components;
- general and basic semiconductors and the technology for manufacturing extremely large integrated circuits;
- high-end software;
- new-generation broadband wireless mobile telecommunications;
- high-end numerical controlled machine tools and basic manufacturing technology;
- large nuclear power plants with advanced pressurized water reactors;
- high-temperature gas-cooled reactors;
- equipment for control and treatment of pollution in water bodies;
- nurture of new genetically modified biological species;
- development of important new drugs;
- large aircraft;
- high-resolution earth observing systems; and
- technologies useful for both military and civilian sectors and defense technology.

This is one good indication of where China's resources are being channeled. But it is obviously not an exclusive list. As we have seen, China has made major strides in the manufacture and installation of high speed rail as well. And it would be very surprising if we did not see a large number of automobiles from China for sale in the U.S. market within a few years.

The fact that there is a national marshalling of resources to attain major commercial progress in the listed projects does not necessarily mean that there will be excess capacity in each. But even if there were no excess supply that would need to be exported, China's attaining a large degree of self-sufficiency in supplying its own market in major product areas would be at odds with the aspirations of its trading partners and very notably would frustrate the central trade objective of the Obama Administration -- doubling U.S. exports in five years. Attaining that Administration goal or even moving very far in that direction will require substantial participation by all of the world's largest markets, including China. But China's goal of increasing self-sufficiency in many sectors has to mean loss of current and potential markets for its trading partners.

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[7] An estimated 23 million units compared with expected demand of 20 million units. KPMG International, *Issues Monitor,* April 2010. China is now the largest market for motor vehicles as well as the world's largest provider (figures 2 and 3).

[8] State Council of the People's Republic of China, *Outline of the National Medium-and Long-Term Program on Scientific and Technological Development (2006-2020),* Feb. 9, 2006.

Taking just one example, for semiconductors, China's Ministry of Information Industry has indicated an objective of significantly increasing its "self-sufficiency ratio":

> *[We will] significantly increase the self-sufficiency ratio to over 70 percent for integrated circuits used for information and national defense security, and to over 30 percent for integrated circuits used in communications and digital household appliances…. . . . We should basically achieve self-sufficiency in the supply of key products.*[9]

In conversations with U.S. industry executives, Chinese officials stated a goal of 85% self sufficiency by 2015. It is likely that a goal of that magnitude will not be achieved, and if it were, the harm to China's development of downstream industries would likely be severe, as competitiveness of information and communications (ITC) products depends on access to the best and latest chips from any source anywhere in the world, at competitive prices.

Chinese Measures of Concern

a. The National Indigenous Innovation Policy (NIIP)

> *The government shall establish a priority procurement policy for important high-tech equipment and products developed by domestic enterprises with independent intellectual property.*
>
> *[We shall] provide policy support to enterprises purchasing domestic high-tech equipment.*

State Council of the People's Republic of China,
Outline of the National Medium-and Long-Term Program
on Scientific and Technological Development (2006-2020)

Former Ways and Means Committee Chairman Sam Gibbons used to say about trade problems that "they do not arrive without any warning. You do not wake up one morning and look out the window and find that there is a glacier in your backyard." The policy of emphasizing "indigenous innovation" -- that is having products made with Chinese-origin technology owned by Chinese companies -- has been in the making for a number of years. It only threatened to become officially operational relatively recently with the publication of procurement regulations favoring indigenous innovation products.

On November 15, 2009, China's Ministry of Science and Technology, the National Development and Reform Commission and the Ministry of Finance issued a joint circular providing for the accreditation of national "Indigenous Innovation Products." The scope of the requirement includes the following: "computing and application hardware, telecommunications hardware, modern office equipment, software,

[9] Ministry of Information Industry, August 29, 2006.

new energy and equipment and highly efficient energy-saving products.[10]" The effect of the catalogue thus created would have denied access to procurement by government agencies of products made by foreign companies selling in the Chinese market, even if they produced product that was 100% local content -- if the technology used did not originate in China (that is, the technology is owned by the Chinese subsidiary of the MNC). At the recent meeting of the Strategic and Economic Dialogue at the end of May, China did not agree to a U.S. request to suspend its indigenous innovation policy "but did agree to provide additional time for U.S. industry and government comments on how it could achieve its goal of promoting innovation in China without discriminating against foreign companies"[11]. No global company's complex portfolio of technologies is 100% sourced in any one country, and least likely to be sourced solely in China as there is a strong concern in China over China's protection of intellectual property. The NIIP would therefore have excluded foreign companies from selling to government agencies. More importantly, although procurement by state-owned enterprises was not officially covered by the discriminatory accreditation measure, in practice, procurement by state-owned enterprises would likely conform to the NIIP.

b. State-owned enterprises (SOEs)

As noted earlier, China made very substantial commitments as part of its accession to the WTO. Many of these obligations are recorded in the WTO's Working Party Report on China's Accession. These commitments are considered binding and enforceable through WTO dispute settlement. Among the most important of the commitments is the statement by the representative of the Government of China that China would ensure that all state-owned and state-invested enterprises would make purchases and sales based solely on commercial considerations, e.g. price, quality, marketability and availability, and that the enterprises of other WTO Members would have an adequate opportunity to compete for sales to and purchases from these enterprises on non-discriminatory terms and conditions. In addition, the Government of China would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, including on the quantity, value or country of origin of any goods purchased or sold, except in a manner consistent with the WTO Agreement.[12]

In sectors where state-owned enterprises are dominant, such as provision of communications services or electric power, the purchasing behavior of SOEs is the determinative factor in whether the market is functioning or not. Foreign firms complain of discrimination generally at the hands of SOEs.

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[10] MOST Notice Regarding the Launch of the National Indigenous Innovation Product Accreditation Work for 2010 (draft for comment), April 10, 2010.
[11] Report on the Remarks of Francisco Sanchez, Undersecretary of International Trade, at WITA, as reported in Inside US Trade, June 4, 2010.
[12] Paragraph 46, Report of the Working Party on the Accession of China,**WT/MIN(01)/3,** 10 November 2001.

c. Standards

[We shall] actively promote the formulation and implementation of technical standards with self-owned intellectual property rights and translate that technological advantage into a marketplace advantage to maximize the benefits of intellectual property rights.

Shanghai Municipal Government,
September 14, 2004.

Throughout the field of information and communications technology products, China has promulgated national standards that are different from those applied internationally. The WTO Agreement on Technical Barriers to Trade (TBT) imposes the following requirement:

2.2 Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade.

The creation and application of a large number of national standards in China, as opposed to use of existing international standards, raises serious questions of WTO compliance. There is a clear market effects as well. A recent example was the delayed roll-out of a national standard (TD-SCDMA) for 3G phones, a delay and a standard that favored domestic producers.

One example that has been the subject of an industry study is that of trusted computing[13]. "Trusted computing" is a security system designed to allow verification that only authorized code runs on a system. China is pursuing a strategy to develop a set of closed, national standards for trusted computing in order to enforce a set of government encryption policies built upon the use of non-public Chinese-origin algorithms, rather than allowing Chinese companies to participate in open, international standards setting. Several rationales can be ascribed for this alternative approach, including national security concerns, a desire to promote indigenous innovation in China, and a policy to minimize payment of royalties to foreign intellectual property rights holders. The adoption of separate national standards pose interoperability and therefore market access problems.

Taking this path of a national approach to trusted computing standards development can also be contrary to China's own interests. It can undermine China's innovation agenda, denying Chinese ICT companies access to the most advanced technology available through global supply chains. It is sufficiently important that if enforced, it can retard China’s economic growth, raising costs for the entire global ICT industry and reduce market opportunities. The closed and non-transparent nature of the Chinese national standard for trusted computing can also undermine the security objective reportedly motivating China’s leaders, as closed specifications are inherently less secure. Open systems ensure full testing for security vulnerabilities before products are released on the market. A closed Chinese national standard for trusted computing – if

[13] *Policy Issues Arising in China’s Development of State-Sponsored Domestic Standards for Trusted Computing,* Dewey & LeBoeuf LLP, a study prepared for the Trusted Computing Group, June, 2009

made mandatory – will undoubtedly reduce consumer confidence in Chinese ICT products.

In an era of globalization which has provided so many advantages for Chinese trade and industrial development, erecting national barriers can be extremely counter-productive.

Similar issues arise with respect to software related to information security. In June 2007, the Ministry of Public Security (MPS), the State Encryption Management Bureau (SEMB), the State Secrets Bureau, and the State Council Informatization Office (SCITO) promulgated the Administrative Measures for the Multi-Level Protection of Information Security (MLPS), which mandated that all systems nationwide be classified into one of five security levels. For today's purposes it is enough to cite Level 3 defined as follows: *The damaged information system causes serious damages to social order and public interests or harm to national security.* This extends the level of "national security" review of information systems well beyond the traditional areas of sensitive government and military networks. Among the systems that must be graded under the MLPS are basic information telecommunications, broadcasting and TV networks, Internet information services entities, and systems related to transportation, banking, insurance, commerce, education, culture, labor and social security.[14]

According to the MLPS Administrative Measures, information security products graded at level 3 or above must meet a number of requirements, including: (1) The product developers and manufacturers must be owned by Chinese citizens, legal persons or the state, and have independent legal personality in China; (2) the core technology and key components of products must have independent Chinese or "indigenous" intellectual property rights; and (3) products that have been listed in the Certification and Accreditation Administration (CNCA) catalogue of information security products must acquire a certificate issued by the National Information Security Center (ISCCC). The Administrative Measures also provide that products containing encryption technology must be approved by the Office of Security Commercial Code Administration (OSCCA), and no imported products with encryption functionality can be used without approval.

The combination of these requirements may significantly restrict the use of foreign information security products in systems classified at Level 3 or higher under the MLPS. It does not strain the imagination to think that were this system of requiring that only Chinese products with Chinese intellectual property be used for education, banking, insurance, etc, not only would the interests of China's trading partners be severely compromised but China's economic development would be smothered.

[14] Ministry of Public Security, Notice on Grading Work of National Important Information System Security Multi-Level Protection, Gong Xin An [2007] No. 861.

d. Currency undervaluation

Ministries of Finance and our own Treasury Department would be reluctant to label the practice of consciously undervaluing a currency as an industrial policy tool which might change the jurisdiction within a government over the policy responses to the trade and industry officials). RMB undervaluation certainly has the effect of enhancing exports and dampening imports of products that are destined for consumption in China – in that respect it is an industrial policy measure. There is a consensus view among many respected economists that whatever methodology is employed, the RMB is undervalued by about 30%. This would, for the United States, be about the same as the rebate at the border of the corporate income tax and charging the equivalent amount on all imports. It is impossible to maintain that doing so would not have profound trade effects. Currency manipulation would seem to be addressed by Article XV of the WTO/GATT which provides that WTO members "shall not, by exchange action, frustrate the intent of the provisions of this Agreement."

The effect on foreign industries of a severe currency misalignment is to turn the healthy garden hose of international competition into a fire hose with devastating effects, particularly domestic industries face competing imports. With respect to exports or investments in China, the impact is less as nonmarket factors may determine sales. If a standard prevents a sale, or a government agency or state-owned enterprise will not buy a product that is not based on indigenous technology, so that price is not a relevant factor in a purchasing decision, currency undervaluation will not matter. There are also complex analyses needed to determine the effects on trade balances of appreciation of the RMB. If a large number of the products sourced in China are assembled in a processing zone from imported content, and the Chinese content and value-added is low, revaluation will not have the anticipated effect.

e. Other measures

Subsidies come in many more targeted forms than the exchange rate. Capital infusions, export credits, industrial development loans, debt forgiveness, etc., as with European launch aid for Airbus, can create an industry and make it a factor in world trade. If the countervailing duty remedy is employed with respect to domestic subsidies in China when products benefiting from the subsidies are exported, much more will be learned of their magnitude and placement. In our firm's studies of industries as varied as telecommunications equipment to oil country tubular goods, we have found a remarkably high incidence of domestic subsidies.

Renewable Energy Electrical Generating Equipment

In preparing this testimony, I was asked to address this green goods sector due to the fact that our firm prepared a study[15] on China's promotion of it.

> *In 2008, the Climate Group, an international nonprofit organization working to address climate change, released a study which concluded that China has emerged as the world's leading producer of energy from renewable resources and would overtake developed countries in creating clean technologies. The Chinese government forecast that in 2009, China led the world not only in installed capacity but total investment in renewable energy. To a considerable extent these developments reflect the impact of China's giant hydropower projects and the continuing installation of small hydropower facilities. However, China's renewable energy profile is increasingly defined by "new renewable" sources of electricity — solar, wind and biomass power. China has emerged as a world leader in the manufacture of solar photovoltaic technology, and is forecast to become the world's leading exporter of wind turbines. China's leaders view these dramatic developments as a reflection of supportive government policies.*[16]

a. Solar energy equipment

> *America pioneered solar PV technology, and, as recently as the mid-1990s we had about 45 percent of the world market share, but we have let that lead slip away. Today, we have only about 5 percent of the world market. The U.S. needs to jump back into the clean energy race and play to win.*

Steven Chu, U.S. Secretary of Energy, May 7, 2010

In 2008, China became the largest producer of solar panels in the world. The U.S. is the fastest growing photovoltaic (PV) market in the world, and is predicted to be the largest PV market this year or next. With heavy subsidies, by the first half of 2009, there were some 50 companies constructing, expanding or preparing polycrystalline silicon production lines in China. China's capacity is forecast this year to about twice world demand.[17] According to China's Ministry of Industry and Information Technology (MIIT), capacity utilization in the Chinese polysilicon industry is only 26%. As actual capacity is only 55% of planned capacity, excess capacity, unless demand skyrockets in the near term, is only going to get very much worse.

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[15] National Foreign Trade Council study, *China's Promotion of the Renewable Electric Power Equipment Industry*, prepared by our firm in March of this year.. http://www.nftc.org/default/Press%20Release/2010/China%20Renewable%20Energy.pdf.

[16] Ibid.

[17] Ibid. The report contains additional data.

Foreign firms had not entered to any large degree the Chinese market but are beginning to. First Solar announced that it will build the world's largest solar plant in Inner Mongolia, and is planning a project to have the largest installed capacity generating plant in the world at this site. With the support of the Wuhan government, Massachusetts solar cell manufacturer Evergreen Solar is planning future expansions in China, working on a new plant with another PV manufacturer, Jiawei Solar (Wuhan) Company and the Wuhan Donghu New Technology Development Zone Management Committee, part of the Wuhan provincial government in Wuhan, China.[18]

Well over 90% of China's PV production is exported (figure 4). Exports of PV modules and panels from China to the United States are expanding rapidly. Solar cells and panel imports from China were up 82.6% in 2009 over 2008. Imports in January to April 2010 were up 159.1% over the same period in 2009. Total value of imports in 2009 was $419 million. Imports in the first four months of 2010 have already reached to $206 million.

b. Wind energy equipment

Subsidies in China for the development of wind power equipment have existed at least since 1986. By 1999, with subsidies, about 40 Chinese companies were producing (mostly small) wind turbines. In the late 1990s, subsidies for R&D to develop larger turbines were granted by the Ministry of Science and Technology (MOST). Chinese government requirements for purchasing of energy from wind farms drove demand. Technology transfers were required of foreign companies with Chinese joint venture partners. An initial local content of 20% was set. Foreign firms could not select their partners and this "Ride the Wind Program" was not judged a success. The State Economic and Trade Commission (SETC) created a National Debt Wind Power Program to provide government loans at subsidized interest rates to wind farm owners who purchased locally made wind power components. During the Ninth Five Year Plan (1996-2000), the local content requirement for National Development and Review Commission (NDRC) projects was increased to 40%, but Chinese companies began to supply equipment with 70-80% local content.

In 2004, NDRC's Wind Power Concession Project was launched. This project would account for most of China's installed wind power capacity. Required local content was moved to 70% and in 2005 was to exceed 70%. In 2005, Vestas, a Danish company, and the world's largest wind turbine producer, won a major bid. Since 2005, no single foreign wind turbine manufacture has won an NDRC concession tender. Foreign share of the Chinese market for annual wind energy equipment procurement has dropped from 75% in 2004 to 13.1% this year. The electric utilities participating in the NDRC projects are state-owned enterprises and they are to a great extent no longer purchasing foreign equipment. Foreign-owned Chinese companies were not considered to be Chinese for purposes of bid evaluation, despite meeting local content requirements. Foreign

[18] http://www.pv-tech.org/news/_a/evergreen_solar_shifts_manufacturing_future_to_china_targets_us1_w_in_2012/.

companies were still selling to some extent in some provincial markets. Recently, a standard has been employed, requiring a minimum turbine size, which has excluded a substantial portion of European manufacturers' products.

In October 2009, China agreed at the Joint Committee on Commerce and Trade (JCCT) to eliminate local content requirements. It is not clear that this commitment has been implemented, nor how meaningful it is, since foreign manufacturers with high local content which they had already achieved could not in any event succeed in selling turbines to NDRC concession projects. Chinese officials claim that Chinese suppliers are simply the lowest bidders. Purchase of equipment based on indigenous technology is still being stressed. Official statements call for opening up the international market for Chinese production. A tariff and VAT rebate was instituted in 2008 to support R&D and production of domestic firms.

By 2009, over 100 wind turbine manufacturers were operating in China. The State Council warned of over-capacity, and financial institutions were restrained in their lending to this sector. Chinese exports of wind turbines have not accounted for very much of Chinese production to date (about US$80 million estimated in 2009), but that could change. China's actual imports of wind turbines from the United States and Europe in 2009 (as opposed to purchases from foreign companies manufacturing in China) was probably less than $10 million in an estimated $8.6 billion market.

On June 10, 2010, the China Wind Energy Association (CWEA) published 2009 data on installed wind power equipment in China. The foreign share of new annual purchases in 2009 fell to 13.1% from 24.4% in 2008 and from 75% as recently as 2004 (figure 5). The cumulative foreign share of total installed capacity fell to 24.1% in 2009 from 38.2% in 2008 and 82.2% in 2004 (figure 6).

Conclusion

China's transformation of its own economy and its integration into the world economy has been a work in progress over these last three decades. By any measure, China has made enormous strides in bringing market forces to bear within its economy, but there have been signs for several years that the period of opening may have come to an end, and market closure may be taking place.

With Japan a few decades ago, there was little understanding by U.S. policymakers of the realities of the Japanese market. Those who sought to sell in that market understood fully that they could not do so, but even they did not have a complete understanding of why that was the case. A number of industries paid for the lack of knowledge and their government was not of much help except in rare cases. Academics and think tanks were generally uninformed as well. The result was a series of bilateral trade conflicts, protection of the U.S. and European markets which was ineffective and might just possibly have been avoided, and in the end decades of economic stagnation for Japan.

China has taken a different course than Japan did and has done much that has provided it with spectacularly positive results. But it has a very large and growing population and its leaders cannot really afford major policy errors. The National Indigenous Innovation Policy is an interesting case in point. The 16th century European scientist Paracelsus opined that a substance given in small doses could function as a medicine which when administered in large doses would be a poison. Rewarding innovation is important. That is why we, and China, have a patent system. Requiring that government agencies purchase goods that were invented in China by Chinese entities will prove counterproductive in age of globalization, and in fact would be counterproductive in any age. Adoption by state-owned enterprises of this behavior multiplies self-inflicted harm of this policy mistake. Penicillin and the structure of DNA were British discoveries. It would have been highly counterproductive to try to have American alternatives. This did not meant that the scientific knowledge from Britain could not be used in American (and in all other) universities to continue to innovate.

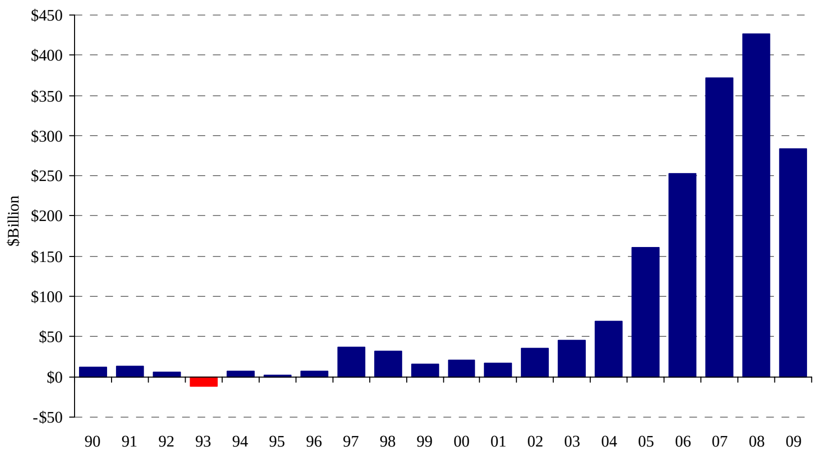
China will have to find its own way. At the same time it is the responsibility of U.S. policymakers to have at hand as complete a picture as possible of foreign industrial and trade policies in order to make informed decisions. The United States must understand the effects of Chinese industrial policies and the implications for the U.S. economy and plan its own strategies with better knowledge of the realities of international competition. That cannot be done today. The requisite information is not available. It is not being systematically collected and evaluated. The United States will pay a price for not doing so.

Alan Wm. Wolff
June 16, 2010

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

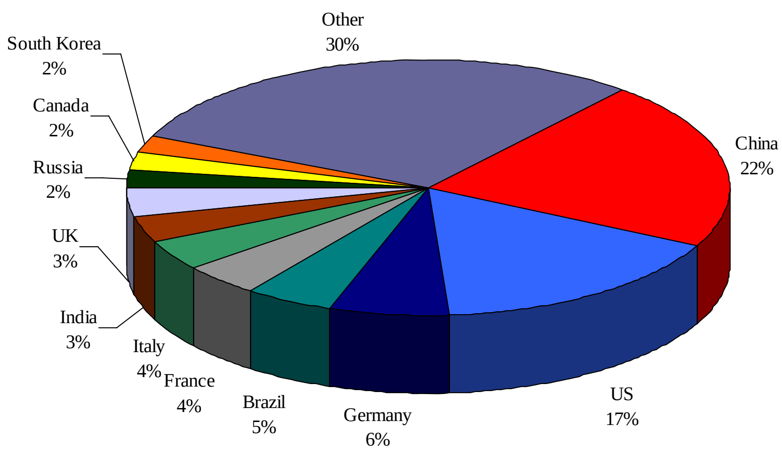
Annex B to this testimony contains a statement delivered last week before the U.S.-China Economic and Security Review Commission on *China in the WTO* which is relevant to any consideration of China's trade policies and its industrial policies that have trade effects.

Figure 1
China's Current Account Surplus Grew Rapidly After Joining the WTO in 2001
1990 to 2009



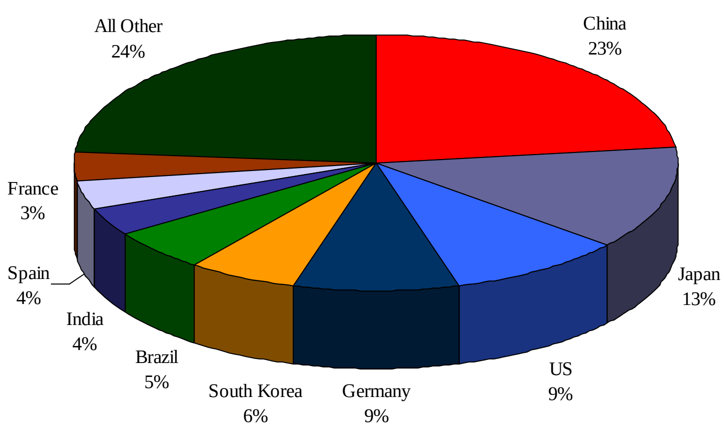
Source: International Monetary Fund

Figure 2
China is the World's Largest Motor Vehicle Market
2009 Sales of Motor Vehicles by Country



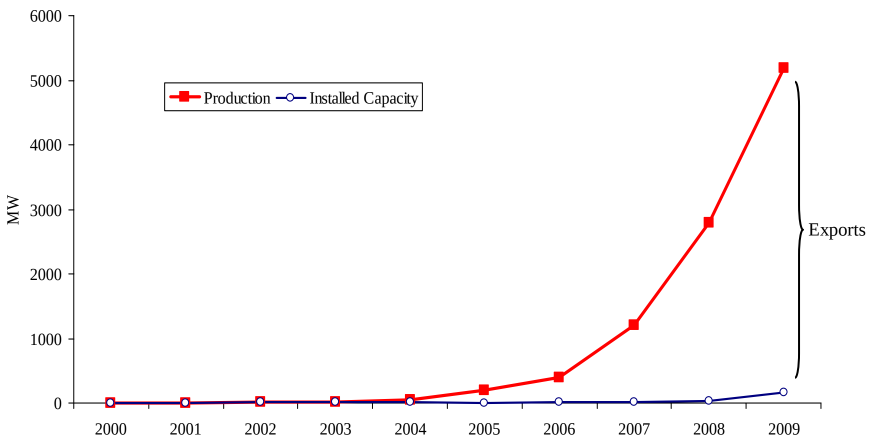
Source: General Motors, *Form 10-K* (April 7, 2010).

Figure 3
China is the Largest Motor Vehicle Producing Country
World Motor Vehicle Production 2009



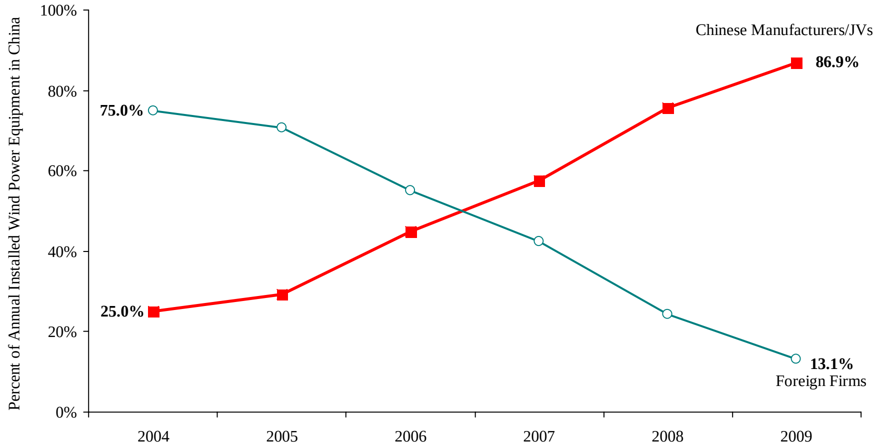
Source: Verhband der Automobilindustrie; SIAM and KAMA. Data are preliminary.

Figure 4
The Growth in Chinese Solar PV Production
Has Greatly Exceeded Installed PV Capacity



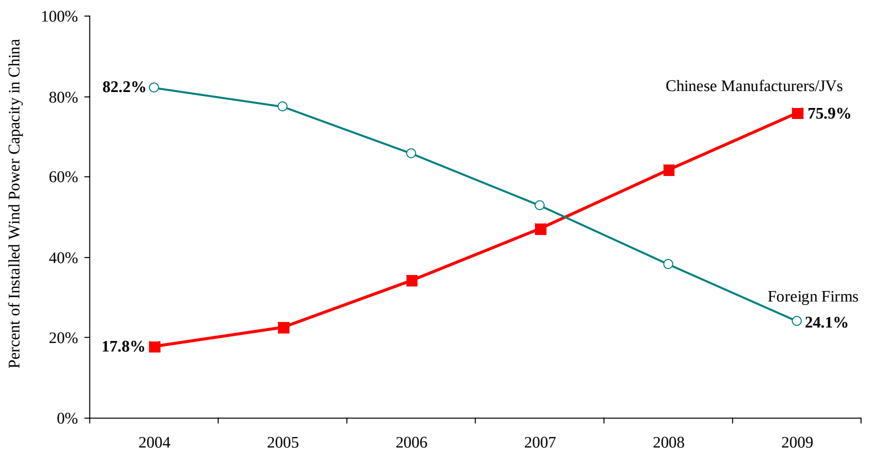
Source: NDRC, GTM Research and EPIA.

Figure 5
The Foreign Share of China's Annual New Purchases of Wind Power Equipment Has Fallen Significantly in the Past Five Years



Source: CWEA, Statistics on Chinese Wind Power Equipment Capacity(年中国风电装机容量统计),various years and 2009年中国风电装机容量统计 中国可再生能源学会风能专业委员会（CWEA).

Figure 6
Chinese Policies Promoting Domestic Producers Have Succeeded
Share of Cumulative Installed Wind Power Equipment Capacity in China



Source: CWEA, Statistics on Chinese Wind Power Equipment Capacity(年中国风电装机容量统计),various years and 2009年中国风电装机容量统计 中国可再生能源学会风能专业委员会（CWEA).

The Extensive Commitments Made by China on Joining the WTO

It is probably safe to conclude that no country has made as many changes to its laws and regulations and to its economy as China committed to do, and in very many cases did do, in order to join the World Trade Organization[19]. Thousands of measures were amended to comply with WTO requirements and with the commitments China made in the course of the accession negotiations. This required not a gradual shift toward accommodation to the rules of the WTO, but in most cases adherence either immediately or after a relatively short delay. China started from a position well behind that of the other BRIC countries and easily exceeded their commitments; and, in no small measure, as a result of the liberalization China's commitments entailed, exceeded their economic performance, as well.[20]

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

- Bound its tariffs on simple (non-trade-weighted average to 10% (agriculture at 15.8%, non-agriculture at 9.1%). This compares with Brazil, which has bound rates at 31.4% (agriculture at 35.5% and non-agriculture at 30.8).and India at 49% (agriculture at 114.2% and non-agriculture at 34.7%);[21]

- In agriculture, committed not to apply any export subsidy upon its accession;[22]

- Pledged that it would provide national treatment for import certification and testing;

- Committed to establish a modern commercial banking system;

- Would not require foreign exchange balancing of imports and exports by any enterprise;

[19] In comparison, by and large, the GATT was constructed to mirror U.S. domestic law rather than requiring its wholesale reform, but the U.S. still had to liberalize with respect to imports into its own market through successive rounds of multilateral trade negotiations.
[20] Implicit in the GATT and its successor, the WTO, is that the rules are being applied to a market economy, although there is nothing explicit in the Agreements that require this as a condition of membership. It became obvious with nonmarket economies that something more was needed, and import targets were set for some of the earlier accessions on NMEs. With China, the approach taken was to negotiate very elaborate and pervasive commitments that were incorporated in the Working Party Report that accompanied the accession. The commitments made by China in the Working Party Report have been found by a WTO panel to be binding on China.
[21] Source: WTO statistical tables on the WTO website. The WTO website shows the U.S. having an average total tariff of 3.5%, 4.8% for agricultural products, and 3.3% for non-agricultural products.
[22] http://www.wto.org/english/news_e/pres01_e/pr243_e.htm

- Committed that its investment guidelines and their implementation would be in full conformity with the WTO Agreement;

- Confirmed that it would ensure that all state-owned and state-invested enterprises would make purchases and sales based solely on commercial considerations, e.g. price, quality, marketability and availability, and that the enterprises of other WTO Members would have an adequate opportunity to compete for sales to and purchases from these enterprises on non-discriminatory terms and conditions; in addition, the Government of China would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, including on the quantity, value or country of origin of any goods purchased or sold, except in a manner consistent with the WTO Agreement;

- Confirmed that, without prejudice to its rights in future negotiations in the Government Procurement Agreement, all laws, regulations and measures relating to the procurement by state-owned and state-invested enterprises of goods and services for commercial sale, production of goods or supply of services for commercial sale, or for non-governmental purposes would not be considered to be laws, regulations and measures relating to government procurement;

- Confirmed that it would from the date of its accession only impose, apply or enforce laws, regulations or measures relating to the transfer of technology, production processes, or other proprietary knowledge to an individual or enterprise in its territory that were not inconsistent with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS Agreement") and the Agreement on Trade-Related Investment Measures ("TRIMs Agreement");

- Confirmed that price controls would not be used for purposes of affording protection to domestic industries or services providers;

- Confirmed that administrative regulations, departmental rules and other central government measures would be promulgated in a timely manner so that its commitments would be fully implemented within the relevant time frames;

- Confirmed that it would in a timely manner annul local regulations, government rules and other local measures that were inconsistent with its obligations;

- Confirmed that it would revise its relevant laws and regulations so that its procedures for judicial review of administrative actions would be consistent with the requirements of the WTO Agreements, and that the tribunals responsible for such reviews would be impartial and independent of the agency entrusted with administrative enforcement, and would not have any substantial interest in the outcome of the matter;

- Confirmed that within three years after accession, all enterprises within China would be granted the right to trade;

- Confirmed that upon accession it would participate in the Information Technology Agreement ("ITA") and would eliminate tariffs on all information technology products as set out in its schedule; and eliminate all other duties and charges for ITA products;

- Confirmed that from the date of accession, it would ensure that its laws, regulations and other measures relating to internal taxes and charges levied on imports would be in full conformity with its WTO obligations and that it would implement such laws, regulations and other measures in full conformity with those obligations;

- Confirmed that the administration of quotas and import licenses, and tariff-rate quotas would be nondiscriminatory, and that allocation would be transparent;

- Confirmed that, upon accession, it would apply fully the Customs Valuation Agreement;

- Confirmed that it would abide by WTO rules in respect of non-automatic export licensing and export restrictions;

- Confirmed that it would eliminate all export subsidies and all subsidies contingent upon the use of domestic over imported goods;

- Stated that it would progressively work towards a full notification of subsidies;

- Stated that it would open up for public comment its standards-making procedures and increasingly base its standards on international standards;

- Confirmed that it would fully comply with the Sanitary and Phytosanitary (SPS) Agreement and would ensure the conformity with the Agreement of all of its laws, regulations, decrees, requirements and procedures relating to SPS measures;

- Stated that all measures applicable to motor vehicle producers restricting the categories, types or models of vehicle permitted for production, would be completely removed two years after accession, thus ensuring that motor vehicle producers would be free to choose the categories, types and models they produced;

- With respect to agricultural imports, it would not maintain, resort or revert to guidance plans or administrative guidance at the national or sub-national level that regulate the quantity, quality or treatment of imports, or constitute import substitution practices or other non-tariff measures, including those maintained through state trading enterprises at the national or sub-national level;

- Noting the advanced state of protection for intellectual property rights in China, confirmed that upon accession it would fully apply the provisions of the TRIPS Agreement, rather than phase in its adherence to the Agreement;

- Committed to permit internal branching for insurance firms consistent with the phase-out of geographic restrictions;

- With respect to its Schedule of Specific Services Commitments, confirmed that, while it had limited its market access commitments in some sectors to permit foreigners to hold only a minority equity interest, a minority shareholder could enforce rights in the investment under its laws, regulations and measures; and moreover, WTO Members would have recourse to WTO dispute settlement to ensure implementation of all commitments in its GATS schedule;

- Confirmed that it would make available to WTO Members translations into one or more of the official languages of the WTO all laws, regulations and other measures pertaining to or affecting trade in goods, services, TRIPS or the control of foreign exchange, and to the maximum extent possible would make these laws, regulations and other measures available before they were implemented or enforced, but in no case later than 90 days after they were implemented or enforced; and

- Stated that it intended to become a Party to the Government Procurement Agreement (GPA) and that until such time, all government entities at the central and sub-national level, as well as any of its public entities other than those engaged in exclusively commercial activities, would conduct their procurement in a transparent manner, and provide all foreign suppliers with equal opportunity to participate in that procurement pursuant to the principle of MFN treatment, i.e., if a procurement was opened to foreign suppliers, all foreign suppliers would be provided with equal opportunity to participate in that procurement (e.g., through the bidding process).

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

Annex B

China in the WTO

Testimony of

Alan Wm. Wolff

Co-chair, International Trade Practice, Dewey & LeBoeuf
Professor, Monterey Institute of International Studies
Chair, Committee on Comparative Innovation Policies,
National Academies

Hearing on

Evaluating China's Role in the World Trade Organization

Before the

U.S. China Economic and Security Review Commission

Washington, D.C.

June 9, 2010

CHINA IN THE WTO

Summary of Written Testimony for Oral Delivery

Mr. Chairman, Members of the Commission, I appreciate the opportunity to testify this morning on *Evaluating China's Role in the World Trade Organization.* I have prepared more extensive written testimony that will, I understand, be published on the Commission's website.

You have posed an extremely important series of questions about America and most of the world's economies choosing to manage their trading relationship with China through the WTO.

In my view, the framework for considering these questions is the following:

America's national security depends on the strength of its economy. Strength is measured in terms of productive capability and ability to innovate. It means having human resources, capital and tools that place the U.S. economy second to none. America's leaders have re-discovered this fundamental truth. Whether we as a country act upon it, base national policies on it, is another matter.

Second, our nation is in a competition with other countries, both economic and political. It is unavoidable, and has always been the case and, unless human nature changes, will always be the case. A principal source of competition now is from a rising power, China. This competition is similar in some respects to that from Japan in the last third of the 20th Century, and markedly different in others. China is much larger, it welcomed other countries' investment as a means of its own economic development as Japan did not, and its foreign policies are certainly less clearly aligned with those of the United States than was the case of Japan. And China is building military capability without being an ally of the United States.

In this context, the following is a very brief summary of my answers to the questions posed by the Commission:

The true test of the WTO as an effective means by which the United States and other nations and China manage their trade relationships will occur in the second decade of China's WTO membership, not the first decade.

This is true for several reasons:

- (1) There is a real question whether China is now in the process of reversing the policy direction of market liberalization set by Deng Xiaoping in 1978. There are policy measures being contemplated and put into place that threaten access both through imports and through foreign direct investment.

- (2) The renminbi is, economists generally agree, severely undervalued, and China's trade surpluses continue to grow.

- (3) The three transitional measures of China’s accession – the review mechanism, the special safeguards, and nonmarket economy antidumping methodology are expiring,

- (4) The WTO rules will be tested where they may prove to be least effective:

  - (a) When national standards are imposed instead of international standards, is this protection actionable?

  - (b) When state-owned and other Chinese enterprises choose not to buy foreign products, can their actions be proven to be state-directed?

  - (c) At what point is a high rate of piracy of intellectual property actionable as a failure to live up to WTO commitments?

  - (d) When a currency is seriously undervalued, will the WTO rules provide an effective remedy?

  - (e) To what extent will domestic subsidies prove to be actionable when they appear to cause import substitution?

  - (f) Will the WTO dispute settlement system’s bias against trade remedies impair effective responses to injury caused by China’s exports?

  - (g) Will China’s purchasing of first stage primary products while resisting processed products and manufactured imports distort the development of emerging economies?

  - (h) And last but not least: if these policies are pursued by China and the WTO's potential weaknesses exploited, will China’s economy stagnate the way Japan’s economy has due to China’s failure to continue to liberalize its economy and a continuing domestic misallocation of resources.

With respect to each of these points, we (and China) can hope for the best but need to be concerned about the worst. China is moving into the implementation phase of the National Indigenous Innovation Policy; there is evidence of a Buy-Chinese procurement bias by state-owned enterprises; in telecommunications and electronic equipment, national standards as opposed international standards are being deployed; there will be resistance within China to any substantial appreciation of the renminbi; and the Antimonopoly Law was used in a high profile case to limit foreign investment. In some sectors, foreign market share has plummeted. (Your recent hearing highlighted the dramatic reduction in foreign companies' sales of wind electrical generating equipment.)

On a spectrum of various types of economies, China's economy is closer to a model of state developmental capitalism at one end of the spectrum, and our own, at the other end, the free market. The WTO agreements implicitly assume that market forces determine competitive outcomes. For this reason, on its accession to the WTO, China was asked for a very long list of commitments in scope and content required of no other WTO member. Those commitments will undoubtedly be severely tested in this second decade of the 21st century.

Greater reliance by China on state-owned enterprises and seeking autarky in innovation will, if this is the direction chosen by China's leaders, lower China's rate of growth and make China's industries less internationally competitive, even as its market closure damages foreign industries.

As for the questions the Commission posed about the first ten years of China's membership, the following are my conclusions:

FIRST. The United States would not have been better off with China outside the WTO. The alternatives -- the imposition of trade sanctions, free use of trade remedies, a form of trade warfare -- were not feasible alternatives, economically, politically, or realistically. To paraphrase Winston Churchill, the WTO is the worst form of structuring trade relations with China but for all the others.[23]

SECOND. In order to join the WTO, China undertook greater changes than any other country ever did in transforming its economy and its system of regulating its economy. Key elements were the opening first to foreign investment and then through WTO accession to foreign goods. China's achievements in this regard were remarkable.

THIRD. There are economic costs to important segments of the United States economy of trade with China, but on the whole these are not greatly affected by whether China is within the WTO or not. The United States was not going to maintain a Cold War tariff level on China's goods and this decision was taken decades before China's WTO accession. Industries which could do so brought antidumping or safeguard actions. I believe that the United States is better off having China in the WTO, and that the alternative was in no way superior. The WTO is not a cure-all, however.

- If going forward China chooses to use measures that are designed to slip past its WTO obligations, where WTO disciplines are not clear-cut or the evidence is not available to support a dispute settlement case, or the political will to bring a case is absent, there will be adverse consequences for U.S. economic and commercial interests.

[23] Section 301 would have been available in theory, but in practice, there is a limit to the number of times that trade retaliation can be employed without destroying bilateral relations. The use of trade sanctions is somewhat overrated as a means of changing a sovereign nation's conduct. Reliance on unilateral measures threatened or imposed under section 301 rather than the employment of the WTO rules, however unsatisfactory they may be, was not a good option for the United States. Whether this remains the case will depend on future circumstances.

- And, more fundamentally, litigation is not an adequate substitute for general adherence to the WTO rules nor should it be used to plug holes in the existing rules – that is the responsibility of the WTO members themselves through negotiations. Unfortunately, the WTO has not evolved an effective means of updating its system of multilateral rules.

In conclusion, Mr. Chairman, I have two recommendations to make:

- First, the United States must devote adequate resources to understanding the nature of competition in and with China. We are paying a price for our ignorance. This needs to be remedied.

- Second, there must be a strategy for enhancing the prospects of the United States in this competition. Pieces of a potential strategy exist, but they are just that, pieces.

One additional question should be posed:

- Are there ways in which the United States and China could cooperate to deal with shared challenges? These could include, for example, developing non-carbon-based technologies, alleviating poverty and disease on a global scale, ensuring food and product safety, enhancing global food supplies, and fostering innovation to these ends.

One should never rule out cooperation as an alternative to potential and real confrontation. It is a form of tough but high-minded pragmatism that America's foremost leaders practiced, Lincoln for one. It is worth thinking about this possibility as well.

China in the WTO
Testimony of
Alan Wm. Wolff
Co-chair, International Trade Practice, Dewey & LeBoeuf
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The relationship of the commerce of nations to their power is a vitally important one. In the case of the relative positions of the United States and China, this Commission, by its mandate, is perhaps the best body in this country to address this subject. Much that is valid and important has been written about how closely fiscal deficits of countries are aligned with their standing in world affairs[24]. Often neglected in these analyses is the position of countries in trade and the impact of trade on the composition of their economies. What a country is able to produce is central to its national well-being and to its prospects. Building on the economist David Ricardo's example of England and Portugal being better off for specializing respectively in textiles and wine, and to engage in trade to their mutual benefit, it should now be recognized that it would matter in terms of the eventual world role each of these countries was ultimately able to play which of them produced the more advanced good and which did not.

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

The lead article in the most recent issue of Foreign Affairs and a prominent piece recently in the New York Times describe China's building a blue-water navy to protect the sea lanes which carry its commerce. Here China is thinking not of the trade that is most written about in the United States and elsewhere, China's massive and expanding exports, but rather China's imports – of oil and raw materials. Outside of export controls, considerations of national security play very little role in the crafting of U.S. trade and domestic economic policies. For its part, China's leaders think in terms of national security when they consider the size and composition of China's economy. They are concerned about maintaining growth not only for increasing the standard of living of the Chinese people but for the resulting domestic social stability. The U.S. government is, of

[24] Niall Fergusson among the best.

course, also concerned with the welfare of its citizens. President Obama has set as a national goal the doubling of exports within five years, driven in large part by a need to reduce unemployment, but also to reduce international monetary imbalances that threaten the financial well-being of the country. In the President's National Security Strategy, delivered to the Congress on May 27, 2010, there is recognition of the relationship of the strength of the economy to national security:

> *Renewing American Leadership—Building at Home, Shaping Abroad*
>
> *Our approach begins with a commitment to build a stronger foundation for American leadership, because what takes place within our borders will determine our strength and influence beyond them. . . ..*
>
> *At the center of our efforts is a commitment to renew our economy, which serves as the wellspring of American power.*

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

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

Examples of America's national mobilizations of resources are to be found in FDR's "Arsenal of Democracy" speech in late December 1940, the American response to the Soviet Union's launch of Sputnik in October, 1957, and President Kennedy's announcement of the lunar manned space flight. And the U.S. government has also supported development of the transistor, the internet, global positioning system technology, aluminum (for WWII), and titanium (for the Korean War). It spends a large amount on health-related research. The EU has claimed that the United States has unfairly supported commercial aircraft through military procurement. However, the role of the U.S. government in creating and maintaining the industrial base is nevertheless comparatively limited, especially when compared with the current industrial policy environment in China. On average, for its industrial base, United States government support is not a major factor for most industries. In this respect China differs. The extent of its promotional policies for industry is a much greater. It is a multiple of that found in Europe (with the prominent exception of airbus) or the United States[25].

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[25] There are numerous examples of U.S. successes in "industrial policy", including creation of a world-class agriculture sector through the Homestead Act, land grant colleges, and numerous other measures in

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

It is in this context that I will address the seven specific questions this Commission sent out for comment[26], with the understanding that you also have accorded your witnesses the freedom to address other issues that they believe to be important.

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

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

> *Why in your view did the U.S. government support China's entry into the WTO?*
>
> *What were the major political and economic goals that the United States hoped to achieve? Have we achieved those goals?*
>
> *Would the U.S. have been better off by not letting China into the WTO but instead using Section 301 to ensure China's compliance with fair and free trade practices?*

Since the Second World War, the United States has led the way in creating a world trading system based on the rule of law and movement toward a global regime for trade in which market forces would determine competitive outcomes. In 2001, the year China joined the WTO, China already ranked within the top ten of the world's exporters

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the 19th and 20th Centuries. The point made above is still valid. The impact of WTO rules on a country like that of China will differ from the impact of these policies on a country like the United States.

3.

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

and importers[27]. Forcing China to remain outside the WTO would have been antithetical to this vision. The United States already accorded China most-favored-nation treatment as a result of a bilateral agreement.[28] It is true that the United States would have been free to terminate that agreement and, had China not become a WTO member, would not have had the application of U.S. trade remedies regulated by binding dispute settlement. It is also true that China's trade commitments under the WTO agreements are far broader than the coverage of any bilateral trade agreement could have achieved.

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

> *China's WTO accession is a clear economic win for the United States. Together with permanent NTR (Normal Trade Relations), it will open the world's largest nation to our goods, farm products and services in a way we have not seen in the modern era.*
>
> U.S. Trade Representative Charlene Barshefsky, February 2000.

Large U.S. headquartered multinational businesses shared this vision. They saw China as a major market and a major source of supply for all other markets including the United States. They also foresaw that a China that was within the WTO would be a more stable place for investment, both to serve the Chinese market and as an export platform[29].

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

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

[29] *Even before the first vote was cast yesterday in Congress's decision to permanently normalize U.S. trade with China, Corporate America was making plans to revolutionize the way it does business on the mainland. And while the debate in Washington focused mainly on the probable lift for U.S. exports to China, many U.S. multinationals have something different in mind. "This deal is about investment, not exports," says Joseph Quinlan, an economist with Morgan Stanley Dean Witter & Co. "U.S. foreign investment is about to overtake U.S. exports as the primary means by which U.S. companies deliver goods to China."* The Wall Street Journal, 25 May 2000, Opening Doors: Congress's Vote Primes U.S. Firms to Boost Investments in China --- Debate Focused on Exports, But for Many Companies, Going Local Is the Goal --- `Looking for Predictability'

The United States also had geopolitical goals -- to work with China on major foreign policy objectives, including those involving North Korea, Iran and possibly Taiwan, as well as to have a relatively stable and potentially positive relationship with a major emerging power. In addition, there was an untested American theory that the more free the play of market forces, the more likely that there would be progress in China toward democracy – a goal the United States promotes wherever it can. It is a hope that economic liberalization would bring with it political liberalization.[30] President Bush said in a statement not dissimilar from Clinton Administration statements:

> *I am confident that China's entry into the WTO will bring other benefits to China beyond the expected economic benefits. WTO membership, for example, will require China to strengthen the rule of law and introduce certain civil reforms, such as the publication of rules. In the long run, an open, rules-based Chinese economy will be an important underpinning for Chinese democratic reform.*[31]

In gauging the value of what the United States and the other WTO members received as part of China's joining the WTO, it is worth recalling the entry price for its accession. It is probably safe to conclude that no country has made as many changes to its laws and regulations and to its economy as China committed to do, and in very many cases did do, in order to join the World Trade Organization[32]. Thousands of measures were amended to comply with WTO requirements and with the commitments China made in the course of the accession negotiations. This required not a gradual shift toward accommodation to the rules of the WTO, but in most cases adherence either immediately or after a relatively short delay. China started from a position well behind that of the other BRIC countries and easily exceeded their commitments; and, in no small measure,

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

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

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

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

as a result of the liberalization China's commitments entailed, exceeded their economic performance, as well.[33]

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

- Bound its tariffs on simple (non-trade-weighted average to 10% (agriculture at 15.8%, non-agriculture at 9.1%). This compares with Brazil, which has bound rates at 31.4% (agriculture at 35.5% and non-ag at 30.8).and India at 49% (agriculture at 114.2% and non-ag at 34.7%);[34]

- In agriculture, committed not to apply any export subsidy upon its accession;[35]

- Pledged that it would provide national treatment for import certification and testing;

- Committed to establish a modern commercial banking system;

- Would not require foreign exchange balancing of imports and exports by any enterprise;

- Committed that its investment guidelines and their implementation would be in full conformity with the WTO Agreement;

- Confirmed that it would ensure that all state-owned and state-invested enterprises would make purchases and sales based solely on commercial considerations, e.g. price, quality, marketability and availability, and that the enterprises of other WTO Members would have an adequate opportunity to compete for sales to and purchases from these enterprises on non-discriminatory terms and conditions; in addition, the Government of China would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, including on the quantity, value or country of origin of any goods purchased or sold, except in a manner consistent with the WTO Agreement;

- Confirmed that, without prejudice to its rights in future negotiations in the Government Procurement Agreement, all laws, regulations and measures relating to the procurement by state-owned and state-invested enterprises of goods and services

[33] Implicit in the GATT and its successor, the WTO, is that the rules are being applied to a market economy, although there is nothing explicit in the Agreements that require this as a condition of membership. It became obvious with nonmarket economies that something more was needed, and import targets were set for some of the earlier accessions on NMEs. With China, the approach taken was to negotiate very elaborate and pervasive commitments that were incorporated in the Working Party Report that accompanied the accession. The commitments made by China in the Working Party Report have been found by a WTO panel to be binding on China.
[34] Source: WTO statistical tables on the WTO website. The WTO website shows the U.S. having an average total tariff of 3.5%, 4.8% for agricultural products, and 3.3% for non-agricultural products.
[35] http://www.wto.org/english/news_e/pres01_e/pr243_e.htm

for commercial sale, production of goods or supply of services for commercial sale, or for non-governmental purposes would not be considered to be laws, regulations and measures relating to government procurement;

- Confirmed that it would from the date of its accession only impose, apply or enforce laws, regulations or measures relating to the transfer of technology, production processes, or other proprietary knowledge to an individual or enterprise in its territory that were not inconsistent with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS Agreement") and the Agreement on Trade-Related Investment Measures ("TRIMs Agreement");

- Confirmed that price controls would not be used for purposes of affording protection to domestic industries or services providers;

- Confirmed that administrative regulations, departmental rules and other central government measures would be promulgated in a timely manner so that its commitments would be fully implemented within the relevant time frames;

- Confirmed that it would in a timely manner annul local regulations, government rules and other local measures that were inconsistent with its obligations;

- Confirmed that it would revise its relevant laws and regulations so that its procedures for judicial review of administrative actions would be consistent with the requirements of the WTO Agreements, and that the tribunals responsible for such reviews would be impartial and independent of the agency entrusted with administrative enforcement, and would not have any substantial interest in the outcome of the matter;

- Confirmed that within three years after accession, all enterprises within China would be granted the right to trade;

- Confirmed that upon accession it would participate in the Information Technology Agreement ("ITA") and would eliminate tariffs on all information technology products as set out in its schedule; and eliminate all other duties and charges for ITA products;

- Confirmed that from the date of accession, it would ensure that its laws, regulations and other measures relating to internal taxes and charges levied on imports would be in full conformity with its WTO obligations and that it would implement such laws, regulations and other measures in full conformity with those obligations;

- Confirmed that the administration of quotas and import licenses, and tariff-rate quotas would be nondiscriminatory, and that allocation would be transparent;

- Confirmed that, upon accession, it would apply fully the Customs Valuation Agreement;

- Confirmed that it would abide by WTO rules in respect of non-automatic export licensing and export restrictions;

- Confirmed that it would eliminate all export subsidies and all subsidies contingent upon the use of domestic over imported goods;

- Stated that it would progressively work towards a full notification of subsidies;

- Stated that it would open up for public comment its standards-making procedures and increasingly base its standards on international standards;

- Confirmed that it would fully comply with the Sanitary and Phytosanitary (SPS) Agreement and would ensure the conformity with the Agreement of all of its laws, regulations, decrees, requirements and procedures relating to SPS measures;

- Stated that all measures applicable to motor vehicle producers restricting the categories, types or models of vehicle permitted for production, would be completely removed two years after accession, thus ensuring that motor vehicle producers would be free to choose the categories, types and models they produced;

- With respect to agricultural imports, it would not maintain, resort or revert to guidance plans or administrative guidance at the national or sub-national level that regulate the quantity, quality or treatment of imports, or constitute import substitution practices or other non-tariff measures, including those maintained through state trading enterprises at the national or sub-national level;

- Noting the advanced state of protection for intellectual property rights in China, confirmed that upon accession it would fully apply the provisions of the TRIPS Agreement, rather than phase in its adherence to the Agreement;

- Committed to permit internal branching for insurance firms consistent with the phase-out of geographic restrictions;

- With respect to its Schedule of Specific Services Commitments, confirmed that, while it had limited its market access commitments in some sectors to permit foreigners to hold only a minority equity interest, a minority shareholder could enforce rights in the investment under its laws, regulations and measures; and moreover, WTO Members would have recourse to WTO dispute settlement to ensure implementation of all commitments in its GATS schedule;

- Confirmed that it would make available to WTO Members translations into one or more of the official languages of the WTO all laws, regulations and other measures pertaining to or affecting trade in goods, services, TRIPS or the control of foreign exchange, and to the maximum extent possible would make these laws, regulations and other measures available before they were implemented or enforced, but in no case later than 90 days after they were implemented or enforced; and

- Stated that it intended to become a Party to the Government Procurement Agreement (GPA) and that until such time, all government entities at the central and sub-national level, as well as any of its public entities other than those engaged in exclusively commercial activities, would conduct their procurement in a transparent manner, and provide all foreign suppliers with equal opportunity to participate in that procurement pursuant to the principle of MFN treatment, i.e., if a procurement was opened to foreign suppliers, all foreign suppliers would be provided with equal opportunity to participate in that procurement (e.g., through the bidding process).

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

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

To accomplish all of the list at one instant in time would have been truly heroic, and one has to believe that some of the pledges, solemn as they were, had to be somewhat aspirational as opposed to being capable of immediate fulfillment. In some cases, perhaps they represented overreaching by China's trading partners, violating the first maxim of seasoned negotiators – never negotiate for more than the other side can deliver. And one could forgive a lot in terms of a shortfall from expected performance -- were it not for China's size and its importance in the international trading system. China's share of world trade in goods was 4.3% in 2001, and was expected to continue to rise quickly.[36] In fact, the countries participating in China's accession negotiation took China's commitments very seriously and there are many statements and actions indicating that to a large degree China did so as well.

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

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

> *In cases where products of Chinese origin are being imported into the territory of any WTO Member in such increased quantities or under such conditions as to cause or threaten to cause market disruption to the domestic producers of like or directly competitive products, the WTO Member so affected may request consultations with China with a view to seeking a mutually satisfactory solution, including whether the affected WTO Member should pursue application of a measure under the Agreement on Safeguards.*
>
> *If, in the course of these bilateral consultations, it is agreed that imports of Chinese origin are such a cause and that action is necessary, China shall take such action as to prevent or remedy the market disruption.*
>
> *If consultations do not lead to an agreement between China and the WTO Member concerned within 60 days of the receipt of a request for consultations, the WTO Member affected shall be free, in respect of such products, to withdraw concessions or otherwise to limit imports only to the extent necessary to prevent or remedy such market disruption.*[37]

Paragraph 242 of the Working Party Report contains a special textile safeguard which allowed[38] an importing WTO member to impose quotas on Chinese textiles. In addition, China agreed to nonmarket economy treatment with respect to antidumping measures for a period not to exceed 15 years after accession, allowing data from surrogate countries to be used to assess costs of production rather than relying on costs of inputs within China.[39]

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

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

[38] Through December 31, 2008.

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

These are other extraordinary aspects of the extraordinary integration of China into the world's system of trading rules. The reforms China enacted were not confined to those negotiated as part of accession. While it was not required to do so by the WTO rules, China adopted an Antimonopoly Law which on its face is designed to assure that market forces, and not restrictive business practices, determine competitive outcomes[40].

Putting aside the imbalance in bilateral trade (which the most fervent boosters of China trade are wont to do), United States exports to China certainly rose after China's WTO accession ($16.3 billion in 2000 increasing to $69.6 billion in 2009[41]). As for greater freedom within China driven by market forces, there have been some improvements in civil society. While there is no easy way of tying this to trade liberalization, the individual's freedom to pursue economic objectives may well lend itself to some progress in political liberty. (The contrary proposition -- namely that the satisfaction gained through greater material well-being could substitute for an increase in political freedom -- can perhaps be argued with equal justification,).

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

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

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

[40] In at least one instance, the application of the law did not seem to serve this ideal: the blocking of Coca Cola's attempted acquisition of Huiyuan Juice Ltd.
[41] The trade U.S. trade deficit with China increased from $83.7 billion in 2000 to $226.9 billion in 2009, down from a peak of $263 billion a year earlier. Source: U.S. China Business Council website.

In terms of managing its economic relations with China, the United States would not have been better off with China outside the WTO. Section 301 would have been available in theory, but in practice there is a limit to the number of times that trade retaliation can be employed without destroying bilateral relations. In the post WWII era, the only truly unilateral uses of section 301 were provoked by the violation by Japan of a bilateral agreement to allow market access for foreign semiconductors and a continuing violation of intellectual property rights by Ukraine. It was the United States acting unilaterally and threatening to do so in other cases that caused other nations to seek binding dispute settlement as part of the world trading rules, and for the first Bush Administration (both USTR and the State Department) to accept it[42]. This effectively repealed section 301 vis-à-vis WTO members. Moreover, the use of trade sanctions is somewhat overrated as a means of changing a sovereign nation's conduct. The application of effective trade sanctions is a long hard process that has been the subject of a substantial amount of academic study. Sanctions imposed by one country and not multilateral are in the usual case not very likely to be effective very often. Reliance on unilateral measures threatened or imposed under section 301 rather than the employment of the WTO rules, however unsatisfactory they may be, was not a good option for the United States. Whether this remains the case, will depend on future circumstances.

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

On the surface, China's participation in the WTO has absorbed a substantial amount of the time of that organization. China is and has been a defendant and respondent in a sizable number of dispute settlement proceedings and China's implementation of its WTO commitments is the subject of intensive Transitional Review Mechanism exercises in which China's accession commitments are the subject of active comment by other WTO members meeting in numerous WTO committees. In these meetings, WTO members do not appear to be reticent about citing defects in China's implementation of its commitments[43]. In addition, China's WTO membership figures heavily in the statistics for antidumping (and now perhaps countervailing duty) cases, but as far as the WTO is concerned the impact is little more than a discussion in the Antidumping Committee and China's adding another voice in the Rules Negotiation for limiting this trade remedy. None of this really changes the character of the WTO.

a. Impact on the institution

When any large country enters an international organization, especially an emerging political and economic superpower, there are effects, some of them quantifiable and some of them speculative. China is the world's largest exporter and the world's third largest importer. One would expect it to be extremely important in a world trade

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[42] By the time that the Clinton Administration finished the Uruguay Round negotiations, this was considered a "done deal", and the USTR Mickey Kantor, although urged to take this back off the table, was unable to do so.
[43] Transitional Review Mechanism exercises have been a major endeavor for China and its largest trading partners. This process is now headed for its final year.

institution. At one level, there will be an impact on the secretariat of the organization. China is the third largest contributor to the WTO's budget, after the United States and Germany. These are not huge sums. In 2010 the U.S. contribution is 24.5m Swiss francs (CHF)[44], for Germany CHF 16.8m, compared with China at CHF 12.2m, Japan CHF 9.6m and the EU 27 at about 40% of the total budget of about CHF 200m.

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

Large contributors naturally want a say in how the organization is run. As a major contributor, China is very conservative on WTO budget expenditures. Whether this has a purpose in terms of policy is obscure -- China is no more conservative than the United States on budget matters. As the Secretariat does not generally engage in policy making, which is left to the WTO members, this should all not matter. A question always exists as to whether, as geographic representation changes, the new hires “check their nationality at the door" and act in a completely neutral manner. Does the culture of the institution change as more Asian and Southern Hemisphere personnel are brought on board? The staffing of dispute settlement panels and of the Appellate Body would certainly matter if there were a shift in the current general neutrality of staff.[45] Would there be a difference in trade philosophy if there were a major shift of geographic representation to countries whose policies are more interventionist? These questions cannot be answered with any certainty.

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

b. Is China a developing country?

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

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

Developing countries are expected to assume a lesser level of obligations, to receive "special and differential treatment". China considers itself to be a developing country (with a per capita GDP of US$ 6600 in 2009[46]). The major developed countries, at a minimum, do not accept China's view, and the other major emerging market countries are very concerned about competition from China. To date, the issue of China's status has been finessed as no agreement is possible.

c. Effect on the Doha Round of Trade Negotiations

There is an effect, however, on the Doha Development Agenda round of multilateral trade negotiations, both by what China does and what it does not do. China is predisposed toward avoiding further liberalization as it has the view, not entirely unfounded, that it engaged in a phenomenal effort of liberalization to join the WTO just nine years ago, and some of its concessions have been phased in even more recently. It also is apparently reluctant to risk lowering its rate of economic growth, fearing an expansion of imports to a greater extent than coveting further expansion of its exports[47].

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

Another aspect of China's WTO membership that is not a positive is that any concession that is given by another emerging country, such as Brazil or India, is seen as further benefiting Chinese exports and exposing those countries' nascent industries to more vigorous competition. China cannot be blamed for just being. This is not the issue. China's government procurement policies and those of its state-owned enterprises do not support the trade interests of others, so other countries do not see a lot of upside for exporting more to China as a result of the Doha Round. This compounds their sensitivity to becoming the recipient of more imports from China. Brazil, Chile, Argentina and others mainly export primary products to China with little value-added. These products are unlikely to face import barriers in China. Their exports of higher value-added goods, and those of others, face the nonmarket aspects of China economy, often in the form of

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[46] CIA, The World Fact Book, https://www.cia.gov/library/publications/the-world-factbook/geos/ch.html.

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

restrictive procurement by state-owned enterprises, standards problems, and various national provincial and regional policies that favor Chinese products over imports. China's import-limiting procurement practices cannot be blamed on its WTO membership, however, just the reverse. China promised to join the Government Procurement Agreement and it is already committed to have its state-owned enterprises purchase solely on a commercial basis. It is the benefits of these commitments that have not yet been realized.

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

What would it require for China to actually take a lead in the WTO? It would have to take up the cause of improving this rules-based system and foster or at least not be at odds with its purpose of liberalization of international transactions. This would very much be in China's interest (although there is no evidence that it sees things this way). There are selective issues that it could lead and still remain consistent with its avoidance of doing anything too dramatic in terms of further trade liberalization. For example, strong leadership for liberalization of ICT (information and communications technology products) would not only be pro-development for the developing world, but would distinctly favor products in which Chinese exports are highly competitive. It would be pro-development, because, for example, mobile phones are the best quick means to promote economic activity in less-developed countries.[48]

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

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

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[48] An oft-cited example is African fishermen getting text messages of market prices so that they can choose which port to land their catch.

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

d. China as a WTO litigant

During its first five years of membership, China was reluctant to bring litigation.[49] During the first five years, not only was China reluctant to bring litigation against others, the reverse was also true. Perhaps it was the "honeymoon" effect. China very often joined cases as a third party (perhaps some 80% of all cases), gaining experience in litigation in this manner. It eventually was targeted as a respondent in a number of cases, and then brought five cases as a complainant, three against the United States and two against the European Union. At least one case involving China is currently active – China as a respondent over its export restrictions on raw materials (rare earths).

By participating as a third party in some seventy dispute settlement panels, China gained self-confidence as a litigant and valuable in-house expertise. It still always uses outside counsel (most often American trade law firms, at least once a French firm, and a Chinese firm; and in the auto parts case, the American firm spoke 90% of the time allotted to China[50]), however. Part of this outsourcing may be due to discomfort over arguing a case in English, the language in which its dispute settlement cases takes place. More important, perhaps, than the possible disability of having to deal in English as a litigant is the benefit to China of having the Chinese language as a shield when a potential complainant thinks of bringing a dispute case against China. It takes major resources to mount a case against China as many of the necessary documents would have to be translated from Chinese, and a complainant would need to rely on research in the Chinese language to ferret out evidence. Only a few WTO members have the resources to mount the required effort to bring a case against China, especially if the practices complained of consist of informal measures.[51]

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

[49] China was a co-complainant in the US steel safeguards case, however. The case was made moot by the Bush Administration's termination of the measure.
[50] USTR bars domestic counsel from participation in WTO proceedings, in a self-defeating policy that has been applied consistently by successive U.S. administrations.
[51] This is somewhat like the problems in an earlier era's problems with the Japanese Government's administrative guidance, or Korea's buy-national campaigns.

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

The United States has chosen to manage its trade relationships with China through the WTO insofar as formal rules are concerned[52]. The idea having been to promote market reforms in China, to welcome the integration of China into the world economy, to maintain reasonably smooth relations with China, to resolve trade problems with a minimum of friction, and to find more occasions for common ground with China in foreign policy matters and to promote social reforms, one can only conclude that the results have been mixed.

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

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

There is another difficulty in assessing success in dispute settlement that goes beyond looking at a simple scorecard of WTO wins v. losses. To be sure, when a case is brought and runs through to conclusion in terms of a judgment or a settlement, and USTR reports China's compliance, that is one measure of success. But there is only one sure way to judge whether a dispute is satisfactorily concluded and that is the effect on sales of products or services to which the complained-of restriction applied. In the case of auto parts, where the U.S. won its case, it would be interesting to ask whether China's restrictions may have served their purpose, with the favorable WTO result coming too

[52] There is practically no statement about the U.S. and China's relations that does not require further explanation. Problem-solving with China is most often attempted by the U.S., the EU, and Japan, for example, bilaterally. In the U.S.-China case, the primary vehicles for seeking to resolve trade problems are the Joint Committee on Commerce and Trade and the Strategic and Economic Dialogue. However, the over-arching context is the existence of the WTO framework of obligations and rules.

late to reverse the damage to U.S. commercial interests. The same is true of local content or technology transfer requirements applied to investments. The requirements may be lifted after they have had the desired effect.[53] The only way to evaluate a victory is to interview the ultimate beneficiaries of a case and seek to get (probably in confidence) their full and honest assessment about the extent of commercial benefits going forward, past damage to commercial interests already having been suffered. Even then, the case may have resolved only part of the problems faced. The United States has had some "wins" in the area of IP enforcement, but the Chinese market is still saturated with pirated software and DVDs. How does one assess a win when China agrees to have its government use licensed software when the market is still largely populated with counterfeits? At least superficially so far the U.S. has fared reasonably well with the cases it has brought.[54] The Audio/Visual and the Financial Information Services cases were heralded as coming out well.

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

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

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

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

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

Japan's prominence in reports of this kind in an earlier era[55]. And areas of concern with respect to China continue to emerge. The Chinese economy is a work in progress. And the progress toward liberalization, like the motion of a pendulum, may have swung as far as it will go at present, and may now be regressing. There is ample reason for attention to be paid by policymakers of all major trading countries.

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

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

China started out as very largely a nonmarket economy when it began its accession process, and there remain substantial vestiges of nonmarket attributes to its economy today. The Chinese government at all levels is far more interventionist in the Chinese economy than is the case in most of the major trading countries (although India and Brazil in their own ways are significant runners-up in this regard). The share of the Chinese economy that is accounted for by state-owned enterprises (SOEs) which according to reports was shrinking for over a decade may have stabilized and reportedly SOEs account for over 50% of China's industrial output[56]. Enforcement of intellectual

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

Inadequate IPR Enforcement*: In China, sales of infringing goods displace legitimate goods, and reduce U.S. access to China's market and other markets affected by China's infringing exports. Inadequate IPR enforcement affects a wide range of products, including films, music, publishing, software, pharmaceuticals, chemicals, information technology, consumer goods, industrial goods, food products, medical devices, electrical equipment, automotive parts, clothing and footwear.*

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

[56] *SOEs still make up a substantial part of the national economy – roughly controlling 30 percent of the total secondary and tertiary assets, or over 50 percent of total industrial assets*. Jan 19, 2010. http://blogs.worldbank.org/eastasiapacific/state-owned-enterprises-in-china-how-big-are-they. For an estimate that the SOEs account for 23% of total assets see, Communiqué on Major Data of the Second

property rights has improved above a very low baseline (e.g. there is a decent possibility in a number of courts in major cities to obtain IP protection through litigation) but is abysmal if one is talking about DVDs, consumer products, software, etc.

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

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

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

National Economic Census (No.1), National Bureau of Statistics of China 2009-12-25. http://www.stats.gov.cn/english/newsandcomingevents/t20091225_402610168.htm

Where the case is highly fact-intensive, there is no substitute for a very substantial effort at obtaining data and engaging in very sophisticated analysis. This kind of effort can only be undertaken by entire U.S. or EU industries or very large companies, and in either case individual companies will be weighing the benefits of prosecuting a case against the risks of proceeding against a government upon whose favor it must rely.[57] This reluctance on the part of foreign industries to use public policy measures to deal with market access problems in China is waning, however. My strong sense is that there is in process within China a movement toward greater implementation of restrictive promotional policies. This is having the unintended effect of uniting foreign business opinion to favor engaging more deeply with the governments of China's major trading partners to push back against these Chinese policies.

At some point, the question may be reached in some sectors, or perhaps more generally, whether the confluence of China's promotional policies constitutes "nullification and impairment" of promised benefits under the WTO agreements[58]. A positive finding by a WTO panel could lead to WTO-authorized foreign retaliation against China's exports.

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

This was not a question posed by the Commission, but fits well into its inquiry. The list of concerns voiced by other WTO member countries about China's practices is very long, and falls roughly into three categories: (1) policies and measures made the subject of formal disputes (listed above); (2) policies and measures that are raised as part of the Transitional Review Mechanism[59]; and (3) an array of policies and measures that are found in agendas of bilateral meetings between China and its trading partners, in government publications of other WTO member countries and in private sector materials (such as reports of foreign chambers of commerce based in China).

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[57] Firms calculate whether the bringing of a case will result in China's cutting off their future path to success in the Chinese market.

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

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

As part of its Protocol of Accession, China agreed to a Transitional Review Mechanism (TRM) consisting of annual reviews for a period of ten years.[60]

> *18. Transitional Review Mechanism*
>
> *1. Those subsidiary bodies[61] of the WTO which have a mandate covering China's commitments under the WTO Agreement or this Protocol shall, within one year after accession … review, as appropriate to their mandate, the implementation by China of the WTO Agreement and of the related provisions of this Protocol.*
>
> *2. The General Council shall, within one year after accession, and in accordance with paragraph 4 below, review the implementation by China of the WTO Agreement and the provisions of this Protocol.*
>
> . . .
>
> *4. The review . . . will take place after accession in each year for eight years. Thereafter there will be a final review in year 10 or at an earlier date decided by the General Council.*

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

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

China is one of the top ten users of antidumping. It should be noted at the outset that this is a highly complex area of trade regulation, and it is difficult to start out in this area fresh and quickly become a very high volume processor of antidumping investigations without problems arising[62]. Member country complaints include, for example, Chinese petitioning companies not providing MOFCOM (China's Ministry of Commerce) with adequate non-confidential summaries of its submissions, depriving interested parties of an ability to adequately defend their interests. Similarly, there were concerns expressed over the level of detail provided by MOFCOM in its disclosure of dumping margin calculations and of the essential facts supporting the positions taken in the preliminary determination; timely access to administrators and favorable consideration of hearing requests; and a wish that administrators not resort to private meetings with selected parties as a principal means to obtain views of parties.

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[60] *Protocol of the Accession of the People's Republic of China*, WT/L/432, 23 November 2001.
[61] Council for Trade in Goods, Council for Trade-Related Aspects of Intellectual Property Rights, Council for Trade in Services, and the Committees on Balance-of-Payments Restrictions, Market Access (covering also ITA), Agriculture, Sanitary and Phytosanitary Measures, Technical Barriers to Trade, Subsidies and Countervailing Measures, Anti-Dumping Measures, Customs Valuation, Rules of Origin, Import Licensing, Trade-Related Investment Measures, Safeguards, and Trade in Financial Services.
[62] The case of India is often cited as processing a vast volume of AD cases with a handful of staff, with the clear implication that there cannot be anything approaching WTO-compliant antidumping investigations and findings.

China has responded that it was in full compliance with its obligations under the Antidumping Agreement.[63]

b. *Market Access*[64]

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

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

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

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

- In the area of SPS, China continued to maintain a number of measures that were non-transparent and appeared to lack scientific bases such as H1N1 restrictions, BSE-related bans, Avian Influenza bans, pathogen standards and residue standards.

- In the investment area, China continued to maintain various restrictions on foreign investment and continued to subject new investments and mergers and acquisitions to vague standards such as "national economic security".

- In the customs valuation area, the practices of China's customs administration still seemed to vary from port to port both in terms of customs clearance procedures and valuation determinations and, in some cases, giving rise to WTO concerns.

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[63] *Chair's Report To The Council For Trade In Goods On Transitional Review Of China*, Committee on Anti-Dumping Practices, G/ADP/18, 28 October 2009.
[64] WORLD TRADE ORGANIZATION, G/MA/W/97, 22 September 2009, (09-4442)

- In the area of technical barriers to trade, China continued to pursue the development of unique national standards despite the existence of well established international standards, apparently with the objective of protecting domestic companies from competing with foreign technologies and standards.

c. Trade-related Intellectual Property Rights

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

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

"The representative of China defended the efficiency and skills of the judiciary in IP enforcement, noted the increase in criminal cases, and argued that the Chinese government had supplied materials demonstrating the effectiveness of China's enforcement. [C]ountries that had gone through different stages following the imperatives of their own development. Even so, 120 years after such systems of IP protection had been drawn up in developed countries, in spite of all the measures taken against piracy, these countries had not yet been able to eliminate piracy and counterfeiting."[65]

d. Other matters

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

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

with its catalogue of disappointments and allegations of failings on the part of Chinese authorities.

> *Has China achieved its goals in joining the WTO?*
>
> *When PRC leaders decided to speed up WTO accession negotiations in the late 1990s, they had a clear goal in mind: to accelerate domestic reforms by introducing external pressures. By committing to China's WTO accession agreement, they attempted to overcome stumbling blocks that hindered the government's reform efforts. These reforms have been aimed at weakening the links between state-owned enterprises (SOEs) and bureaucrats and at streamlining and reinvigorating the declining state-owned sector, inefficient but powerful government agencies, and the poorly performing financial sector.*
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> Wang Yong, Associate Professor of International Political Economy and Director of the Center for International Political Economy, Beijing University. *China Business Review,* September-October 2006.

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

1) *It was a logical next step in China's spurring growth through continuing domestic economic reform. Liberalization of trade was necessary to take advantage of liberalization of inward investment and to continue and expand the inflow of foreign investmen*t. China had before it the negative model of its own pre-liberalization period (pre-1978) as well as that of the Soviet bloc, as compared with the positive examples of the Asian tigers. Only in the context of opening its own market could China attract foreign investors with their advanced technologies, develop world-competitive industries, and (it was felt desirable at the time) move further away from State-ownership and a command economy. Joining the WTO gave much needed added impetus to instituting the rule of law and giving greater play to market forces. The impact of these forces and rules would themselves reform the Chinese economy, in many instances without direct state intervention.

2) *China needed to be assured of foreign markets for its exports.* While the Accession did include special safeguard clauses and trade remedies, there was a limit to the frequency and effects of their imposition: they would be reviewable by "neutral" WTO dispute settlement panels[66]. Outside the WTO, there was very little other than

[66] Neutral in terms of which country is the respondent. But there is, I believe a policy bias against trade remedies and this means that the benefit of the doubt would often go to the WTO member challenging a trade remedy measure.

diplomacy and economic power to determine whether Chinese goods would cross borders – a sort of law of the frontier. Businesses thrive on certainty. Unpredictability in the imposition of foreign trade barriers would undermine continued direct investment into China as well as the growth of indigenous industry aiming to enable China to serve world markets. Multinational companies needed to bring in capital equipment, materials and be able to be assured of export markets from a Chinese platform. China-based enterprises regardless of ownership needed to have the same assurance.

3) *China needed to be assured that supplies of raw materials, industrial inputs and food would be available without the imposition of arbitrary foreign export restrictions.* China's need for oil, minerals and food was and is vast, and it was foreseeable that demand for these inputs would continue to expand. Supply assurance would be a strong motivating force.

4) *Absent China's WTO accession, the world could discriminate against Chinese goods and China as a destination for the world's raw materials, agricultural commodities and manufactured goods.* China could not afford to not only lack assurance of markets and supplies; it could not afford to be the only major trading country without that assurance. It is one thing to be denied access to supplies and to markets. This problem is compounded if other nations which were WTO members had guarantees of access and China did not.

5) *China needed a means to defend its trade interests in a routine manner.* WTO dispute settlement procedures provided a means for doing so. Diplomacy and economic strength cannot be effectively deployed to resolve trade problems on all occasions.

6) *For China, with its grand history, and enormous national pride, to assume what it saw as its rightful role in world affairs, WTO membership was an essential prerequisite.* China could not aspire to leadership of any bloc of nations or with respect to any global economic subject without being a WTO member.

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

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

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

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

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

China's seven cases in which it is the complainant against other WTO members are somewhat more revealing. All but one[67] concern foreign trade remedy measures

[67] *U.S. Poultry*

imposed either as safeguards (steel and tires) or antidumping and countervailing duty (AD/CVD) cases. In the case of the Bush Administration's steel safeguard action, it was a multilateral measure and the complaints were from many countries -- China was joined by 14 other WTO members in the proceeding. While this author believes the measure was fully justified, the WTO found against the United States. The measure had largely served its purpose when the Bush Administration terminated it after a finding adverse to its position, and cited non-WTO reasons for doing so. A case against the U.S. for its AD/CVD methodologies has been joined by 14 other WTO members. A case brought by China against the EU's imposition of antidumping duties on steel fasteners was joined by 11 other WTO members. The case on coated free sheet was a request for consultations only (with the United States). The remaining case is a footwear AD complaint against the EU that is still pending. China is also an active participant in other countries' cases, 65 or more of them, and as noted previously, this was presumably as much as anything to learn how dispute settlement worked.

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

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

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

The bottom line: China believes, according to repeated statements of its officials, that its goods (and its potential imports of high technology goods and technologies) and its exports are being discriminated against.[68] However, this is not to say that China would be better off outside the safety of the WTO rules, or that its officials believe even for a moment that this would be the case.

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

This is a question that deserves intensive study. It is as far-reaching and complex a question as whether the formation of the European Common Market (now European Union) has been positive or negative for the United States. One can picture using a supercomputer and feeding in data on the impact on Boeing of competition from Airbus, on exports of U.S. poultry, and many thousands of other examples, both in terms of trade with Europe and exchanges with third countries. There is an old and unsettled argument about customs unions and free trade agreements as to whether they are more trade creating or trade distorting[69]. One thing that is always missing in an analysis of the past is the ability to assess with any great validity the economic effects of alternative courses of events using counter-factual assumptions. One has the instinctive feeling, perhaps because the U.S. strongly supported formation of the European Economic Community, that the question is no longer asked whether the formation of the common market was on balance beneficial for the U.S. in economic terms. On the foreign policy side, the U.S. can assume that it got what it was seeking – so far.

The assessment has not been made of the economic costs and benefits to the United States of China joining the WTO. The experience has been both positive and not entirely positive. In any trade negotiation, there is a balance of what is given and what is received (viewed as negotiators do, in mercantilist terms – that is, increased market opportunities received for those granted). One factor that would have to be taken into account is the exchange rate, which when not justified by fundamentals, swamps any effects of tariff liberalization. There is a widespread conclusion in the economics profession that China's currency is undervalued by 20 to 40%[70], which would have the effective tariff in China the equivalent almost of the bound rates of India and Brazil in many cases. Factoring in an undervalued RMB would make a mockery of China's tariff

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

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

[70] The Peterson Institute for International Economics issued a policy brief earlier this year indicating the consensus view using various methodologies was of undervaluation of the RMB of 30%. Arvind Subramanian, Peterson Institute for International Economics, Policy Brief 10-8.

concessions. It would also cause a gross imbalance in the concessions made as compared with those received. It would be the equivalent of the United States being able to rebate the equivalent amount of its direct (mostly, income) taxes on exports and charge the same amount on imports. In short, it would constitute a radical change in the commercial and economic relationship of the participants in the WTO.

To a Mexican producer of apparel, the added barrier it would face on its exports to China would be huge (assuming that its products would be otherwise cost competitive) and a massive violation of the WTO/GATT's export subsidy ban, and it would face an added Great Tariff Wall its goods seeking entry to China. But this is a somewhat over-simplified view. Exchange rates reduce the price of imported raw materials, sub-assemblies and parts with which China produces its exports. China's value-added for many products, particularly those assembled in export processing zones from foreign parts, may be relatively slight. In addition, in other instances, there are a great many nontariff factors that govern trade flows. Where China has already required high domestic content (say for a foreign investor to be eligible to supply its market), the exchange rate effect on foreign companies' sales could be negligible -- depending on the limited degree to which foreign inputs were required to produce the products in question. Or take the case where raw material imports are subject to contracts that allowed purchasing at concessionary prices in terms of a basket of freely floating currencies. Here too revaluation of the RMB would not affect trade in the short term as much as might be at first thought. [71] And, more fundamentally, what would the equilibrium exchange rate of the RMB be if capital controls were entirely eliminated? The WTO is really absent (perhaps with leave) from something which must of necessity by of fundamental interest to it – the value of currencies.[72]

The product sector-specific effects of nontariff measures cannot be estimated other than by a very close analysis of the individual sector. If one examines government procurement, then in theory neither government is buying from the other, but this is just

[71] The actual effects of revaluation of the RMB v. the U.S. dollar are speculative at best. The top exports to from the United States to China are products such as aircraft, semiconductors, soybeans, scrap and other raw materials. To what extent are aircraft chosen on the basis of initial purchase price? Compared to what competitive products? The Euro is currently weak. Semiconductors are presumably largely re-exported once imbedded in a downstream product. Would an exchange rate change alter the sourcing or quantity of semiconductors (often complex chips perhaps not made competitively elsewhere)? Soybeans could be sourced in Brazil. How much would scrap exports be increased by an RMB revaluation? Is this good for the U.S. economy? Much of the trade is presumably in industrial intermediates (perhaps in large part from offshore U.S. facilities)? What would the impact be on this trade, and what is the interest of U.S. policymakers in this trade? At some point services will account for an increasing proportion of US-China trade? Are these services exports likely to be much affected by what may be only a modest change in exchange rate? To be sure, there is head-to-head competition between China's exports and other countries goods, including some U.S. goods. And China is increasingly offering competition in goods the U.S. produces. Would there be any advantage China had in selling competing goods in the U.S. market (telecom switches, wind turbines) be dampened with a major alteration of currency relationships? Yes. But the effects cannot be readily estimated by economists. This is especially true if price is not a key determinant in SOE purchases for example, which may not be primarily driven by market factors.

[72] See WTO Art. XV.4: "Contracting parties shall not, by exchange action, frustrate* the intent of the provisions of this Agreement. . . ."

theoretical. If all Vitamin C is sourced in China, then VA hospitals buy from China. Similarly, where there is a product that is made only in the United States, perhaps a microprocessor, then some electronics products will be purchased by governments in China with that core element in them. Where local content requirements apply, or there was a desire to take advantage of lower wage rates in China, or an imperative felt to be closer to the market, or a wish to tap into the Chinese talent pool of less expensive engineers, each of these factors could have caused plants to locate in China. How then does one assess what trade effects would occur from RMB appreciation? In the event, the current WTO provisions have not been seen as an effective counter to currency undervaluation.

CONCLUSION

So one is left with approximations, instinct, and assumptions. I do not believe that the United States would have been much more closed to China's exports in any across-the board manner had China not acceded to the WTO. One would have to assume that the United States government would have used its freedom from WTO rules to stop in many cases its own companies from sourcing product where costs were lowest, which in many cases, was and is China. In certain sectors, such as textiles and apparel, trade would have shifted to other low-wage countries if the U.S. restricted Chinese exports across-the-board.

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

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

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

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

If China chose a course of extensive protectionism[73], there would be damage to China's trade relations with other countries. Foreign firms would see their balance of interests shift from viewing China as an extremely important market requiring the quiet acceptance of restrictive Chinese policies to taking a more proactive stance to solving the problems China's protective and promotional measures create. Ultimately the work would be done to bring WTO cases and China could not necessarily rely on prevailing in them, leading to disruptions of its trade and investment.

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

RECOMMENDATIONS

I would close with two recommendations for U.S. policy[74]:

1. *Remedying the shortfalls in information and analysis*

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

> *The United States Government is poorly organized to manage our increasingly complex relationship with China. We are not adequately informed about developments within China . . . and we dedicate insufficient resources to understand China.*[75]

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

[74] I have indicated throughout this paper changes in direction for Chinese policies in the WTO and at home, but accept that foreign advice may not be sought by the Government of China on these subjects.

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

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

2. *Adopting a national strategy.*

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

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

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June 9, 2010

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