June 9, 2010
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Testimony Before the U.S.-China Economic and Security Review Commission:
<u>Evaluating China's Role in the World Trade Organization Over the Past Decade</u>

I. Introduction

I appreciate the opportunity to submit this paper on the a very important topic – the economic, political, and security implications of the accession of the People's Republic of China ("China") to membership in the World Trade Organization ("WTO"). I agree with the members of the U.S.-China Economic and Security Review Commission ("USCC") that ten years after Congress approved permanent normal trade relations ("PNTR") with China, it is appropriate to look back at what was expected to happen, consider what has actually happened, and ponder what lessons can be drawn from the experience.

This paper has four major parts. First, I analyze the major claims made by those who supported PNTR. I show that during that debate, U.S. policymakers and the public were repeatedly told that China's WTO accession would lead to significant economic and trade benefits for the United States. Second, I analyze the record of the last ten years, and conclude that, for the most part, those promises have not been fulfilled. Third, I examine why the optimistic expectations associated with China's WTO accession were not accurate. I conclude that there were several fundamental problems, including the following: (1) U.S. policymakers did not recognize the extent to which China's economic and political system is fundamentally incompatible with our conception of the WTO; (2) U.S. policymakers significantly misjudged the incentives for Western businesses to shift their operations to China and serve the U.S. market from there; and (3) the U.S. government has been very passive in response to Chinese mercantilism. Finally, I discuss what steps U.S. officials should take to address the problems caused by China's WTO accession. I conclude that, as a general matter, we should adopt a significantly more aggressive approach than we have followed thus far.

II. Background

Before turning to these points, it will be useful to briefly summarize the path that led to PNTR. Before China joined the WTO, it was subject to the Jackson-Vanik Amendment ("Jackson-Vanik") to the Trade Act of 1974.[2] Jackson-Vanik denies most-favored nation ("MFN") status to non-market countries that restrict emigration.[3] The President may waive the application of

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2 19 U.S.C. § 2432 (2006).

3 Jackson-Vanik is named after its two major co-sponsors, Sen. Henry ("Scoop") Jackson (D-Wash.) and Rep. Charles Vanik (D-Ohio). It was originally passed in response to policies by the Soviet Union that restricted emigration by Soviet Jews. *See* Statement of Sen. Henry Jackson (D-Wash.), 120 Cong. Rec. 39781, 39782 (Dec. 13, 1974); Statement of Rep. Charles Vanik (D-Ohio), 119 Cong. Rec. 40794, 40794-40795 (Dec. 11, 1973).

Jackson-Vanik with respect to a particular country on a yearly basis, but any such waiver may be overridden by a joint resolution of Congress.[4] Starting in the late 1970s, American presidents regularly waived this provision with respect to China.[5] After the Tiananmen Square protests of 1989, however, these waivers became highly controversial, and each year Congress fiercely debated whether to override the Presidential waiver.[6] While none of the annual waivers was overridden, the ongoing controversy certainly resulted in uncertainty about the long-term future of U.S.-China trade.

It was against this background that China sought admission to the WTO. As part of the accession process, Congress voted on whether to provide China MFN status (also referred to as "normal trade relations")[7] on a *permanent* basis.[8] After a debate in which supporters repeatedly emphasized the likely benefits of China's WTO accession to the United States, the House of Representatives approved PNTR on May 24, 2000 by a vote of 237 to 197.[9] The Senate gave its

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4 19 U.S.C. §§ 2432(c) and 2432(d) (2006).

5 Vladmir N. Pregelj, "Most-Favored-Nation Status of the People's Republic of China" (Dec. 6, 1996), available at http://www.fas.org.

6 *Id.*

7 The shift in terminology from the traditional "most-favored nation" to allegedly less controversial "normal trade relations" was itself part of the effort to approve PNTR. This shift was made to provide political cover to members of Congress concerned about the political consequences of appearing to show "favor" to an authoritarian nation such as China. *See* William H. Cooper, *CRS Report for Congress: The Jackson-Vanik Amendment and Candidate Countries for WTO Accession: Issues for Congress* (March 14, 2006) at 2 n.2.

8 Under Article I of the General Agreement on Tariffs and Trade ("GATT") provides any WTO member providing MFN status to another WTO member must give the same status to all WTO members. The Clinton Administration argued that if China joined the WTO and the United States did not grant PNTR to China, then the United States would likely be forced to invoke Article XIII of the GATT. This article, also known as the "non-application clause," can be invoked by either a current WTO member or an acceding WTO member if either member does not consent to the application of WTO agreements to each other. If the United States (or China) had invoked Article XIII, the WTO agreements technically would not have applied between the United States at China. *See* Congressional Research Service Report RS20139, "China and the World Trade Organization," (Apr. 5, 2001), available at http://ncseonline.org.

Supporters of PNTR regularly claimed that China would join the WTO regardless of whether Congress approved PNTR for China, and therefore the only issue was whether Americans would receive the same benefits of China's WTO accession as other WTO members. *See, e.g.*, Charlene Barshefsky, "China's WTO Accession: Think of It as an Opportunity for Illinois," *Chicago Tribune* (May 12, 2000) (hereafter "Barshefsky article"). It should be pointed out, however, that the process by which China entered the WTO was quite tortuous, and that other countries beside the United States had serious concerns about China's WTO accession. *See generally* Raj Bhala, "Enter the Dragon: An Essay on China's WTO Accession Saga," 15 Am. U. Int'l L. Rev. 1469 (2000). As a practical matter, therefore, a decision by Congress to reject PNTR could have had significant consequences for China's WTO membership.

9 *See* Recorded Vote on H.R. 4444 (May 24, 2000), available at http://thomas.loc.gov.

approval on September 19, 2000 by a vote of 83-15.[10] China officially acceded to the WTO on December 11, 2001.[11]

III. Primary Claims Made in Favor of PNTR

Supporters of PNTR made numerous arguments in favor of their position. In this paper, I have focused solely on claims relating to trade and the economy.[12] As discussed in more detail below, those arguments can be grouped into three major categories:

- -- Granting PNTR would open China's markets to the United States, thereby creating new opportunities for U.S. companies and workers.
- -- It would encourage China to adopt a more transparent legal system and to abide by the rule of law.
- -- It would require virtually no concessions from the United States.

A. <u>Market Access and Economic Benefits</u>

The most prominent claim made by proponents of PNTR was that by acceding to the WTO, China would eliminate tariffs and other barriers to trade, thereby significantly opening its markets to U.S. goods and services. A publication from the Center for Trade Policy Studies at the Cato Institute summarized this argument as follows:

> The economic benefits of granting PNTR to the United States are clear. As the U.S. market is already largely open to Chinese imports, *it is primarily U.S. exporters who will benefit*. Granting PNTR to China will enable U.S. companies to take full advantage of the sweeping market access provisions that China has agreed to adopt in order to comply with WTO rules and obligations.[13]

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10 *See* Senate Roll Call Vote on H.R. 4444 (Sept. 19, 2000), available at http://www.senate.gov.

11 *See* "China and the WTO," available at http://www.wto.org.

12 Thus, for example, this paper does not address claims that PNTR would lead to an improvement in China's record with respect to human rights and the environment, or that it would improve U.S. national security.

13 Mark A. Groombridge, "A Vote for PNTR is a vote for the U.S. Economy and Chinese Reform," (May 28, 2000) (emphasis added), available at http://www.freetrade.org (hereinafter "Groombridge Article"). Mr. Groombridge made similar claims in the summer of 2001. *See* Mark A. Groombridge, "China's Accession to the WTO: A Winning Outcome for both China and the United States," (July 24, 2001), available at http://www.cato.org ("Economically, the United States stands to gain a great deal from China's accession to the WTO.")

One supporter said that U.S. farmers would benefit as China eliminated unscientific barriers that had been used to discriminate against beef and other agricultural imports in the past.[14] President Clinton pointed to industry claims that American high-tech companies – such as manufacturers of computers, semiconductors, and audio-video equipment – would gain from improved access to growing Chinese demand for their products[15] He further pledged that PNTR would "greatly increase the opportunities open to professional services such as law firms, management consulting, accountants, and environmental services."[16]

Supporters also argued that the market reforms China would implement as part of its accession to the WTO would encourage even further market liberalization. In May 2000, for example, Alan Greenspan (then serving as the Chairman of the Federal Reserve Board of Governors) stated that "{f}urther development of China's trading relationships with the United States and other industrial countries" would serve to strengthen China's "commitment to economic reform."[17] A September 2000 press release from President Clinton indicated that we could expect China "to privatize its state-owned industries and expand the role of the market in the Chinese economy."[18]

Proponents repeatedly emphasized that such liberalization would lead to more high-paying American jobs and a lowering of the U.S. trade deficit with China.[19] Robert Kapp, President of the U.S.-China Business Council, summarized this view in vivid language:

> "Opening China's markets to U.S. products and services under this agreement is *the biggest single step we can take to reduce America's growing trade deficit with China*, a problem we have faced for a decade," Kapp pointed out. "With American tariffs near zero and non-tariff barriers few and far between *we're not*

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14 Gene B. Sperling, Director, National Economic Council, "Permanent Normal Trade Relations and the Potential for a More Open China," Remarks before the Dallas Ambassadors Forum (May 12, 2000), *available at* http://clinton5.nara.gov/WH/EOP/nec/html/PunkeChinaSpeech1.html.

15 *See, e.g.*, President Clinton, Press Release, "President Clinton Announces Broad New National Support For Congressional Action Granting China Permanent Normal Trade Relations Status" (Apr. 3, 2000) (quoting a letter signed by nearly 200 high-tech CEOs), *available at* http://clinton6.nara.gov/2000/04/2000-04-03-fact-sheet-on-granting-china-permanent-normal-trade-relations.html ("April 3, 2000 Press Release from President Clinton").

16 President Clinton, Press Release, "Permanent normal trade relations for China: An historic moment for U.S.-China relations" (Sept. 19, 2000), *available at* http://clinton5.nara.gov/WH/new/html/Tue_Oct_3_164420_2000.html ("Sept. 19, 2000 Press Release from President Clinton").

17 Remarks by Chairman Alan Greenspan, Permanent normal trade relations with China, at the White House, Washington, D.C. (May 18, 2000), *available at* http://www.federalreserve.gov/boarddocs/speeches/2000/20000518.htm.

18 *See* Sept. 19, 2000 Press Release from President Clinton.

19 *See, e.g.,* April 3, 2000 Press Release from President Clinton.

talking about a 'gift' for China in PNTR; we're talking about bringing home the bacon."[20]

In an April 2000 press release, President Clinton quoted a letter from numerous CEOs who said that granting PNTR would "increase U.S. jobs and *reduce our trade deficit*."[21] A few months previously, then-presidential candidate George W. Bush said that granting PNTR would "provide American businesses and farmers access to China's growing market *and narrow our trade deficit with China*."[22] Rep. William R. Archer (R-Tex.) said that PNTR would lead to "hundreds of thousands of new higher-paying jobs for American workers."[23]

B. <u>Strengthening The Rule of Law</u>

Supporters contended that China's accession to the WTO would strengthen the rule of law in that country. President Clinton stated that China would be required "to publish laws and regulations" concerning trade to the WTO.[24] Proponents argued that such exposure would, in turn, pressure the Chinese government to restructure its institutions and respect the rule of law.[25] For example, Rep. James P. Moran (D-Va.) stated that bringing China into the global free enterprise economy would "shine a much-needed light on its government" and thus make it more accountable to its own citizens.[26] President Clinton maintained that such developments would not be limited to Chinese domestic laws, but that accession would also "increase the likelihood that China will play by global rules as well."[27] A key point in this argument was that the United States could use the WTO dispute settlement process to pursue claims against China.[28]

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20 Press Release, U.S.-China Business Council, "US-China Business Council Welcomes Administration Moves on Permanent Normal Trade Relations with China," (Jan. 10, 2000) (emphasis added), available at http://www.uschina.org.

21 April 3, 2000 Press Release from President Clinton (emphasis added).

22 The Associated Press, January 5, 2000, *available at* http://www.uschina.org/public/wto/gao/voices.pdf (emphasis added).

23 Statement of Representative William R. Archer (Texas), 146 Cong. Rec. H. 3596 (May 23, 2000).

24 *See* Sept. 19, 2000 Press Release from President Clinton.

25 Statement of Senator William V. Roth, Jr. (Delaware), 146 Cong. Rec. S8726-S8727. *See also* "China, Trade, and Democracy," *PBS Online NewsHour* (Dec. 1, 1999), available at http://www.pbs.org ("Dec. 1999 PBS Online") (quoting Prof. Stanley Lubman of Stanford Law School as saying that "{E}ntry into the WTO ought to provide momentum to legal reforms that have been ongoing.")

26 Statement of Representative James P. Moran (Virginia), 147 Cong. Rec. H4303-02, H4307. *See also* PBS Online NewsHour (Dec. 1, 1999) (quoting Drew Liu, Executive Director of the Chinese Strategic Institute, as saying that "the WTO, you know, stabilized the international environment and create{d} the kind of condition incentive, as well, so China can gradually evolve towards, you know, democracy and constitutional democracy.")

27 *See* Sept. 19, 2000 Press Release from President Clinton.

28 Frederick M. Abbott, American Society of International Law, "China's Accession to the WTO" (Jan. 1998), *available at* http://www.asil.org/insigh13.cfm.

In this context, supporters emphasized that acceding to the WTO would cause China to show more respect for other countries' intellectual property rights ("IPR"). For example, a coalition of America's "creative industries" pointed out that China had committed to bring its IPR regime into compliance with both its substantive and enforcement obligations under the WTO's Trade-Related Intellectual Property Rights Agreement *immediately* upon accession.[29]

C. No Downside for the United States

Proponents assured Americans that China's accession to the WTO presented no downside for the United States. President Clinton explained that PNTR meant "China made unilateral concessions; we will simply maintain the market access policies we already apply to China."[30] In a March 2000 press conference, he expanded on this point:

> The United States doesn't lower any tariffs. We don't change any trade laws. We do nothing. They have to lower tariffs. They open up telecommunications for investment. They allow us to sell cars made in America in China at much lower tariffs. They allow us to put our own distributorships over there. They allow us to put our own parts over there. We don't have to transfer technology or do joint manufacturing in China anymore. *This is a hundred-to-nothing deal for America when it comes to the economic consequences.*[31]

On the House floor, Rep. John LaFalce (D-N.Y.) claimed that PNTR was a "clear winner for our exports."[32] U.S. Trade Representative Charlene Barshefsky went said that "{i}f we turn down a set of one-way concessions made by China, we will make a very dark statement about our ability to develop a stable and mutually beneficial relationship with the world's largest country."[33]

The Business Coalition for U.S.-China Trade made a similar argument in a particularly blunt manner:

> In return {for making various concessions to join the WTO}, China's 'reward' from the U.S. is? . . . ZERO. ZIP. NOTHING. NADA. That's right. China gets no increased access to U.S. markets, no cuts in U.S. tariffs, no special removal of U.S. import restrictions. That's because our market is already open to Chinese imports.[34]

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29 An Open Letter In Support of China PNTR From America's Creative Industries (Feb. 23, 2000), *available at* http://www.iipa.com/rbi/2000_CHINA_PNTR.pdf.

30 *See* Sept. 19, 2000 Press Release from President Clinton.

31 Press Conference by the President (March 29, 2000), available at http://clinton6.nara.gov.

32 Statement of Representative John LaFalce (New York) 146 Cong Rec H 3599 (May 23, 2000) (emphasis added).

33 Barshefsky article at 1.

34 Business Coalition for U.S.-China Trade, "Fact Watch: Correcting the Record on China Trade Issues," (March 2, 2000), *available at* http://www.uschina.org/public/wto/b4ct/fact0302.html.

Doug Bandow of the Cato Institute was extremely critical of PNTR doubters on this point:

> *The silliest argument against PNTR is that Chinese imports would overwhelm U.S. industry.* In fact, American workers are far more productive than their Chinese counterparts.
>
> Moreover, Beijing's manufacturing exports to the United States remain small about half the level of those from Mexico. *PNTR would create far more export opportunities for American than Chinese concerns.*[35]

President Clinton further emphasized that "no agreement on WTO accession has ever contained stronger measures to strengthen guarantees of fair trade and to address practices that distort trade and investment."[36] In particular, he pointed out that China had "agreed to a country-specific safeguard that is stronger and more targeted relief than that provided under our current Section 201 law."[37] This safeguard, he said, would ensure that the United States could "take effective action in case of increased imports of a particular product from China that cause or threaten to cause market disruption in the United States."[38]

IV. What Actually Happened

We now have ten years' worth of data to show what happened after PNTR was approved. It is appropriate to consider whether the promises made at the time have been fulfilled. Unfortunately, the evidence demonstrates that they have not:

-- The economic benefits promised by PNTR supporters have not materialized. In fact, the U.S. trade deficit with China *almost tripled* from 2000 to 2009, and millions of U.S. manufacturing jobs have been lost.

-- China's commitment to the rule of law is very much in doubt, and the U.S. government continues to express major concerns about China's failure to respect U.S. IPR.

-- Chinese mercantilism has had devastating effects on the U.S. economy.

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35 Doug Bandow, "Trade with China: Business Profits or Human Rights?" *Cato.org* (May 5, 2000) (emphasis added), available at http://www.cato.org.

36 *See* Sept. 19, 2000 Press Release from President Clinton.

37 *Id.*

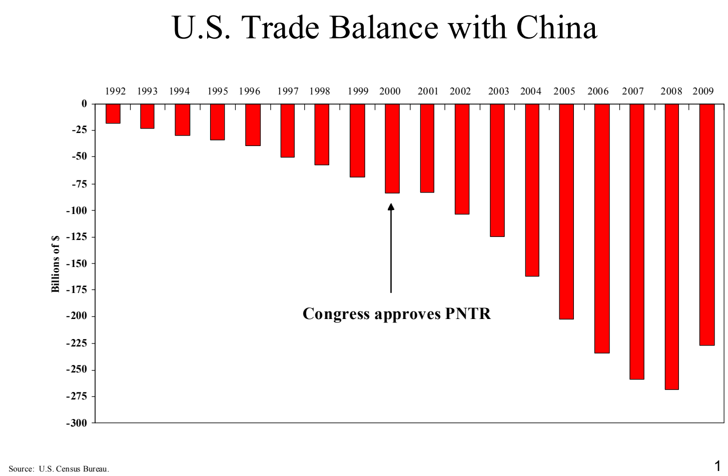
38 *Id.*

A. The United States Has Not Received the Economic Benefits Promised by PNTR Supporters

Unfortunately, the optimistic belief that PNTR would significantly lower the U.S. trade deficit, create huge numbers of high-paying jobs, and provide American companies with untrammeled access to China's enormous market has not been borne out by subsequent events. Indeed, there are strong reasons to believe that China's WTO accession has had negative consequences for the U.S. economy.

The U.S. trade deficit with China has almost tripled over the last decade, rising from $83.1 billion in 2000 to $226.8 billion in 2009[39] – an increase of *172.9 percent.*[40]

Figure 1



Although U.S. exports to China did grow after 2000, that growth was overwhelmed by the much larger increase in U.S. imports from China.

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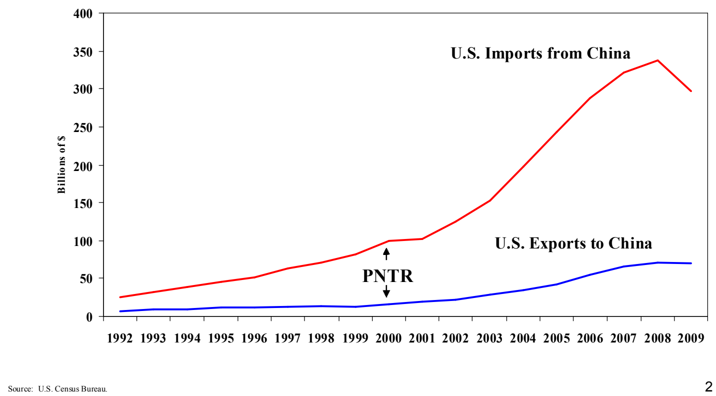
39 *See* Foreign Trade Statistcs, U.S. Department of Commerce, "U.S. Trade with China," available at http://www.census.gov.

40 226.8 – 83.1 = 143.7; 143.7 / 83.1 = 1.729 = 172.9 percent.

Figure 2

U.S. Trade with China



Furthermore, this trade deficit reflects a surge in high-tech imports from China. Indeed, our trade deficit with China in computers, electrical equipment, appliances, and components has exploded, rising from $28.6 billion in 2000 to $109.6 billion in 2009.[41] By one estimate, rapidly-growing imports of computer and electronic parts accounted for more than 40 percent of the increase in the U.S. trade deficit with China from 2001 to 2008.[42] Some 627,000 U.S. jobs in computer and electronic products were eliminated during this period.[43]

Of course, China's influence is not limited to the high-tech field. As shown below, in 2000 China accounted for roughly one quarter of our total trade deficit with regard to non-petroleum goods. By 2009, however, that figure had increased to *roughly 80 percent.*

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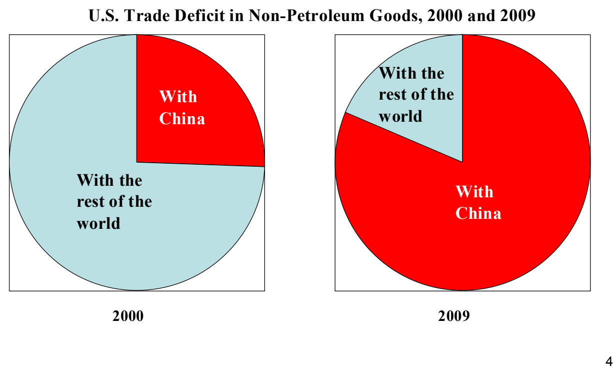
[41] Trade Stats Express, Office of Trade and Industry Information, U.S. Department of Commerce, "NAICS Codes 334 and 335 – Balance with China."

[42] Robert E. Scott, "Unfair China Trade Costs Local Jobs," Economic Policy Institute (Mar. 23, 2010) ("Unfair China Trade Costs Local Jobs") at 2, *available at* http://www.epi.org .

[43] *Id.*

Figure 3

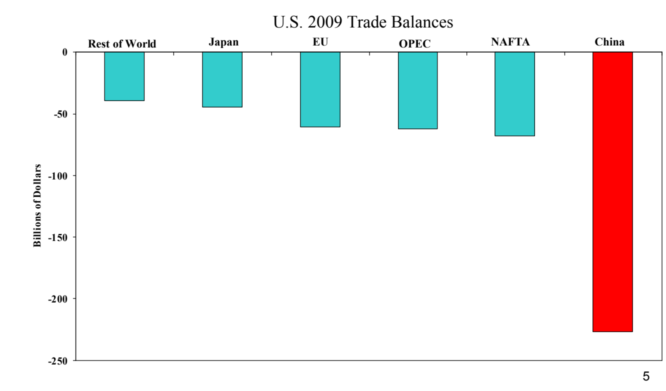
Since 2000, China Has Come to Dominate Our
Non-Petroleum Trade Deficit



In terms of our overall trade deficit (including trade in petroleum), it is clear that China is by far the major source of our difficulties:

Figure 4

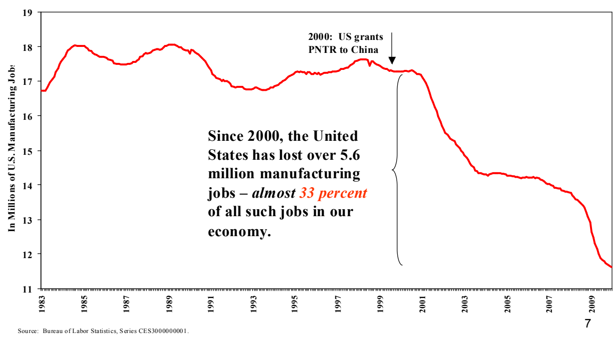
China Is By Far Our Biggest Trade Problem



The claim that PNTR would result in "hundreds of thousands of new high-paying jobs" for American workers has also been discredited. As shown below, since 2000 the United States has lost over *5.6 million* manufacturing jobs – almost *one third* of all such jobs in our economy:

Figure 5

U.S. Manufacturing Jobs, 1983-2009



In fact, between 2001 and 2009, the United States, shuttered 42,400 factories, including 36 percent of factories that employ more than 1,000 workers, and 38 percent of factories that employ between 500 and 999 workers.[44]

It seems clear that the U.S. manufacturing crisis is related to our trade with China. One estimate states that between 2001 and 2008, the growing trade deficit between the United States and China resulted in 2.4 million American jobs being lost or displaced.[45] Nor is this trend likely to end. At the beginning of this year, the Nobel Prize-winning economist Paul Krugman wrote that "{m}y back-of-the-envelope calculations suggest that for the next couple of years Chinese mercantilism may end up reducing U.S. employment by around 1.4 million jobs."[46] The overall harm suffered by U.S. workers as a result of China trade goes even deeper than these figures suggest:

> Competition with low-wage workers from less-developed countries has also driven down wages for other workers in manufacturing and reduced the wages and bargaining power of similar workers throughout the economy. The impact has affected essentially all production workers with less than a four-year college degree – roughly 70 percent of the private-sector workforce, or about 100 million workers. For a typical full-time median-wage earner in 2006, these indirect losses totaled approximately \$1,400 per worker.[47]

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44 Richard McCormack, "The Plight of American Manufacturing," *The American Prospect* (Dec. 21, 2009), available at http://www.prospect.org.

45 Unfair China Trade Costs Local Jobs at 3.

46 Paul Krugman, "Chinese New Year," *The New York Times* (Jan. 1, 2010) ("Chinese New Year"), available at http://www.nytimes.com.

47 Unfair China Trade Costs Local Jobs at 1.

Furthermore, U.S. businesses trying to enter the Chinese market continue to face an array of market-distorting barriers. For example, China manipulates standards and technical regulations in order to protect its high-tech companies from international competition.[48] China also uses the regulatory process to frustrate attempts by U.S. service suppliers to enter its market.[49] Even in agriculture, a rare bright spot for U.S. producers in the Chinese market,[50] USTR has complained that "China remains among the least transparent and predictable of the world's major markets for agricultural products."[51] As these facts show, the sweeping access to China's market promised by President Clinton and others simply has not materialized.

It should also be noted that China's accession to the WTO has *not* generated significant forward momentum for market liberalizing practices. USTR recently reported that "beginning in 2006, progress toward further market liberalization began to slow."[52] Last year, USTR identified numerous examples of a trend toward an even more restrictive trade regime in China, including: (1) tighter limits on Chinese exports of key raw materials, (2) the increased use of unique national standards to hinder sales of high-tech items from other countries, (3) new restrictions on non-Chinese providers of high-end services; and (4) the selective use of border measures to encourage or discourage trade in particular products.[53]

In short, overwhelming evidence shows that the most important claim made in support of PNTR – that it would bring significant economic benefits to U.S. workers and businesses – was simply wrong. Our trade deficit with China has exploded, millions of U.S. manufacturing jobs have been lost, China continues to maintain significant market barriers to block our exports, and the current trend within China is *away* from further liberalization. Last year, U.S. Commerce Secretary Gary Locke summarized the situation by stating that "the United States and China's trade relationship has to evolve. There are concerns and deep structural issues that must be addressed."[54] Chief among these issues "is a bilateral trade imbalance *that simply can't be sustained*."[55]

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[48] USTR, "2010 Technical Barriers to Trade Report" (March 2010) at 50-51.

[49] USTR, "2009 Report to Congress on China's WTO Compliance" (Dec. 2009) ("2009 USTR Report") at 9.

[50] The U.S. trade surplus in agriculture and livestock products with China grew from $626 million in 2000 to $9.4 billion in 2009. Trade Stats Express, Office of Trade and Industry Information, U.S. Department of Commerce, "NAICS Code 11 – Balance with China." Of course, this figure is miniscule by comparison to the overall U.S. trade deficit with China of more than $200 billion per year.

[51] 2009 USTR Report at 8.

[52] *Id.* at 4.

[53] *Id* at 4-5.

[54] Doug Palmer, "U.S.-China trade imbalance not sustainable – Locke," *Reuters* (July 15, 2009) ("Trade imbalance not sustainable"), available at http://www.reuters.com.

[55] *Id.* (emphasis added).

B. Lack of Progress Toward the "Rule of Law"

Supporters of PNTR contended that China's WTO accession would encourage support for the rule of law within that country. Ten years later, however, China has not even complied with its WTO obligations – much less adopted the "rule of law" as we know it. USTR's most recent report regarding China's WTO compliance identified a number of problems, including: (1) poor enforcement of IPR laws and regulations,[56] (2) the use of export restrictions in violation of WTO commitments,[57] (3) the use of investment rules to protect Chinese industries,[58] and (4) pressure from the Chinese government on non-Chinese companies to license their technology or intellectual property on unfavorable terms.[59]

These are not isolated problems, but part of a broader resistance within China to key WTO norms such as "national treatment" (giving others the same market access as one's own nationals), providing MFN status to all members (*i.e.*, not discriminating among trading partners), and "transparency" (making rules as clear and public as possible). USTR has admitted that by 2006, it was "clear that some parts of the Chinese government did not yet fully embrace the key WTO principles of market access, non-discrimination and transparency or the carefully negotiated conditions for China's WTO accession designed to lead to significantly reduced levels of trade-distorting government intervention."[60] USTR further commented that "China's difficulties *in fully implementing the rule of law* exacerbated this situation."[61]

USTR is not alone in recognizing that China has failed to comply with its WTO obligations. One recent analysis pointed out that because China "has yet to meet many of the obligations delineated in its protocol of accession . . . . European and American business groups investing in China perceive China as becoming more interventionist and protectionist."[62] Indeed, China's failed legal system not only contributes to the U.S.-China trade deficit, but threatens the WTO itself:

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[56] 2009 USTR Report at 5. In June 2009, the WTO adopted a dispute settlement panel report holding that Chinese law does not adequately provide for the protection and enforcement of IPR on a wide range of products. *See* Press Release from USTR, "World Trade Organization Adopts Panel Report in China – Intellectual Property Rights Dispute," (June 22, 2009). Nevertheless, in December 2009, USTR reported that "Effective IPR enforcement has not been achieved, and IPR infringement remains a serious problem throughout China." 2009 USTR Report at 13.

[57] 2009 USTR Report at 6-7.

[58] *Id.*

[59] *Id.* at 7.

[60] *Id.* at 4.

[61] *Id.* (emphasis added)

[62] Susan Ariel Aaronson, "Is China Killing the WTO?" *International Economy* (Winter 2010) ("Is China Killing the WTO?") at 41, available at http://www.international-economy.com.

> China's competitive advantage is to some degree based on its inadequate governance – it fails to enforce its own laws in a transparent, evenhanded manner. China's system is broken. And because it is broken, its inadequate governance affects its trade partners – and ultimately, could break the WTO.[63]

There are several reasons by China's political system is fundamentally at odds with the American conception of the "rule of law." At the national level, the Communist Party is willing to ignore international commitments to maintain power.[64] Moreover, the Communist Party owns and operates, or is tied to, private enterprises in key sectors such as transportation, energy, and banking.[65] China also suffers inadequate governance at the provincial level – a result of many factors including corruption, a lack of uniformity among rules, and arbitrary abuse of power.[66] Finally, China suffers from a culture of non-compliance "where bad actors set the norm, where laws and regulations are often ignored or unevenly enforced, and where many citizens and market actors don't know or can't obtain their rights under the law."[67]

C. **<u>A Significant Downside for the United States</u>**

PNTR proponents assured U.S. policymakers that China's accession to the WTO presented no downside for the United States. Yet as already discussed, between 2001 and 2009, the trade deficit between the United States and China almost tripled. As early as 2006, Paul Krugman was warning that the U.S. trade deficit with China was "unsustainable" and that economic consequences of this deficit "will be ugly."[68] Now it is broadly recognized that our trade deficit with China is a major problem. As discussed above, Commerce Secretary Locke has said that our trade deficit with China "simply can't be sustained."[69] In November 2009, Treasury Secretary Timothy Geithner emphasized that the pattern of trade must change:

> {T}he financial crisis . . . showed clearly that previous global economic patterns were unsustainable. To establish a more global foundation for growth and avert future crises of this nature, *we must rebalance global demand*.
>
> As U.S. consumers save more and spend less in the years ahead, and as our government embarks on a path of fiscal responsibility, *emerging markets and economies with large and sustained surpluses will need to shift their growth towards domestic demand and reduce their reliance on exports.* Governments

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63 *Id.*

64 *Id.*

65 *Id.*

66 *Id.*

67 *Id.*

68 Paul Krugman, "Debt and Denial," *The New York Times* (Feb. 13, 2006).

69 Trade imbalance not sustainable at 1.

> around the world will need to accept this basic reality or we will all face slower growth.[70]

Indeed, it seems clear that our trade deficit with China played a major role in creating the financial bubble that exploded in 2008. Due in large part to its growing surplus with the United States, China's reserves of foreign currency soared from $165 billion in 2000 to $2.4 trillion by the end of 2009.[71] Professor Niall Ferguson of Harvard University recently explained how those reserves contributed to the current economic crisis:

> This unprecedented accumulation of reserves opened up a Pandora's box of financial distortions. Chinese purchases of U.S. Treasuries kept their prices above and hence their yields below where they would otherwise have been. Lower long-term interest rates enabled American households to increase consumption levels and widened the gap between savings and investment. And, because foreign savings were predominantly channeled through government (or central bank) hands into safe assets such as Treasuries, private investors turned elsewhere in search of higher yields. *This encouraged financial engineers to develop new financial products such as collateralized debt obligations.*[72]

Once again, therefore, we see that proponents of PNTR were severely mistaken about its real-world consequences.

V. Why Proponents of PNTR Were So Wrong

As shown above, the claims made by supporters of PNTR have been discredited by subsequent events. This fact raises an important question: Why were so many experts – from across the political spectrum – so mistaken? In my opinion, U.S. policymakers made six critical mistakes:

-- They failed to adequately account for many unique facts about China, including its political system, its commitment to mercantilism, and the potential size of its economy.

-- They misjudged the relationship between China and the WTO.

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70 Secretary of the Treasury Timothy F. Geithner, Written Testimony before the Senate Foreign Relations Committee (Nov. 17, 2009), available at http://www.ustreas.gov (emphasis added).

71 Niall Ferguson, "The End of Chimerica: Amicable Divorce or Currency War?" Testimony before the Committee on Ways and Means of the U.S. House of Representatives (March 24, 2010) at 4, available at http://waysandmeans.house.gov.

72 *Id.* (emphasis added). *See also* David Ignatius, "European bailout only postpones day of reckoning," *Washington Post* (May 13, 2010) ("the underlying problem here is the global imbalance that produced a savings glut in some parts of the world (China, Germany) that, in turn, fueled low interest rates that understated the riskiness of some investments (subprime mortgages, Greek bonds . . . . Until those imbalances are checked, we can look forward to new asset bubbles and new panics").

-- They disregarded the incentives for Western companies to shift production to China and ship goods from there to the United States.

-- They gave up critical tools that could have provided leverage to push China toward market liberalization.

-- They have failed to adequately use the remaining tools available to them.

-- They suffered from hubris about the "inevitable" triumph of democracy and capitalism, and therefore overlooked the strengths that would enable China's economy to outperform our own.

Each of these points is discussed in more detail below.

Misjudging China. PNTR supporters repeatedly asserted that China would open its markets and submit its laws to international norms. In other words, they assumed that acceding to the WTO would cause China to become more and more Western in its behavior – almost as if it were merely a more exotic version of Canada. But this is not the case. China has a very different culture and government from ours, and integrating China into the WTO was always going to be extremely challenging.

First and foremost, numerous scholars have questioned whether – given its lack of institutional capacity and the complexity of its constitutional, administrative, and legal system – China is even capable of complying with its WTO obligations.[73] Indeed, China's inability to comply appears to be the result of deep forces in Chinese life:

> China's historical and cultural traditions may clash with WTO transparency norms, either because China's local regulatory culture emphasizes the sovereignty of government bureaucracy and the Party rather than the rights of individuals and society to be informed of government decisions and to challenge these decisions, or because in China, personal connections rather than transparent, formal administrative processes have been the primary means of securing access to information, including information related to government activities.[74]

In short, the notion that China would easily submit to the dictates of an international organization like the WTO was misguided. Furthermore, as discussed in more detail below, the WTO dispute

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73 *See, e.g.*, Ljiljana Biukovic, "Selective Adaptation of WTO Transparency Norms and Local Practices in China and Japan," 11 J. Int'l Econ. L. 803 (2008).

74 *Id. See also* Robert Wolfe, "Regulatory Transparency, Developing Countries and the WTO," 2 World Trade Review 157 (2003), at 158; Pitman B. Potter, "Globalization and Economic Regulation in China: Selective Adaptation of Globalized Norms and Practices," 1 Wash. U. Global Stud. L. Rev. 119 (2003); Sylvia Ostry, "China and the WTO: Transparency Issue," 3 UCLA J. Int'l L. and Foreign Aff. 1 (1998); Gregory Stein, "Acquiring Land Use Rights in Today's China: A Snapshot from on the Ground," 24 UCLA Pacific Basin L. J. 1 (2006)

settlement system is simply not designed to deal with a legal and political system so at odds with the basic premises on which the WTO was founded.

Second, China's government faces enormous pressure to provide jobs for its people. Indeed, it is widely recognized that large-scale unemployment within China would likely result in severe social unrest.[75] Former Secretary of Labor Robert Reich has stated bluntly that "{e}ach year, tens of millions of poor Chinese pour into large cities from the countryside in pursuit of better-paying work. If they don't find it, China risks riots and other upheaval."[76] Rather than trusting free markets to provide these all-important jobs, Chinese leaders rely on what one analyst has called a form of "state capitalism, a system in which the state functions as the leading economic actor and *uses markets primarily for political gain.*"[77]

Third, China's model of "state capitalism" leads to mercantilism. As part of China's system, specific large companies receive government patronage in the form of credit, contracts, and subsidies.[78] The Chinese government, in turn, sees these "national champions" as a means of competing with foreign rivals and encourages their dominant role in the domestic economy and in export markets.[79] A recent report from *The New York Times* confirms the close connection between China's government and key Chinese companies:

> The trend toward {Chinese policies that favor} Chinese-owned companies . . . has been driven by a powerful combination of economic nationalism and an evolving blend of capitalism and socialism. Partly state-owned corporations, armed with lobbyists, have gained considerable influence over the state. Many Chinese executives are former party cadre members whose primary concern now is making a profit, not balancing long-term international policy considerations.[80]

James McGregor, former chairman of the American Chamber of Commerce in the People's Republic of China, has reached a similar conclusion:

> As part of their "China model," that country's leaders have decided that key sectors of the economy will remain "state dominated," including automotive,

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75 Chris Buckley, "China seen facing wave of unrest in 2009," *Reuters* (Jan. 6, 2009) (reporting on a statement by Xinhua, China's official news agency, that faltering growth in China could spark anger and riots among millions of jobless migrant workers and university graduates).

76 Robert Reich, "Obama, China, and Wishful Thinking about American Jobs," *The Huffington Post* (Nov. 17, 2009) ("Wishful Thinking").

77 Ian Bremmer, "State Capitalism Comes of Age," Foreign Affairs (May/June 2009) ("Capitalism Comes of Age") (emphasis added).

78 *Id.*

79 *Id.*

80 Keith Bradsher, "Foreign Companies Chafe at China's Restrictions" *New York Times* (May 16, 2010) ("Foreign Companies Chafe at Restrictions"), available at http://www.nytimes.com.

> chemical, construction, electronic information, equipment manufacturing, iron and steel, non-ferrous metals, and science and technology. Others will stay "largely in state hands," including aviation, coal, defense, electric power and grid, oil and petrochemicals, shipping and telecommunications. State-owned companies in these industries are thriving in their protected home market. They have buckets of cash and easy access to state bank loans to carry out government directives to pursue overseas acquisitions and "go global."[81]

As Robert Reich puts it, "{t}he Chinese government also wants to create more jobs in China, and it will continue to rely on exports."[82]

Fourth, China's leaders are determined to promote technology and innovation in their country. During the debate over PNTR, some Americans adopted the somewhat patronizing position that as U.S.-China trade matured, China would concentrate on relatively "low-tech" goods, while we would maintain a competitive advantage in "high-tech" products.[83] But China is actively promoting so-called "indigenous" innovation at the expense of its trading partners. USTR recently criticized a policy whereby companies seeking to sell high-tech goods to China's government – a very significant portion of the China market – would have to originally register their intellectual property in China:

> A troubling trend that has emerged . . . is China's willingness to encourage domestic or "indigenous" innovation at the cost of foreign innovation and technologies. For example . . . in November 2009, China issued the Circular on Launching the 2009 National Indigenous Innovation Product Accreditation Work with the aim of improving "indigenous" innovation in computer and other technology equipment. *In order to qualify as "indigenous" innovation under the accreditation system, and therefore be entitled to procurement preferences, a products intellectual property must originally be registered in China.*[84]

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81 James McGregor, "Time to rethink U.S.-China trade relations," *Washington Post* (May 19, 2010) ("Time to Rethink Relations"). China's recent policies with respect to the development of green technologies provide a good example of how Chinese state capitalism distorts true market-based competition:

"State-controlled banks are providing generous loans at near-zero interest rates to Chinese-owned companies that manufacture clean energy equipment like solar panels. And foreign-owned companies that set up wind farms in China have been banned from selling carbon-emissions credits to businesses in Europe, denying these companies millions in revenue even as Chinese-owned companies with wind farms are allowed to sell the credits." Foreign Companies Chafe at Restrictions at 2.

82 Wishful Thinking at 1

83 *See*, *e.g.*, Lynn Hulsey, "As low-tech work goes overseas, high-tech jobs fill void, governor says," Dayton Daily News, (May 18, 2000); Rafiq Dossani & Martin Kenney, "Value Creation in the Global Economy: The Changing Role of India and China" (July 2, 2009), available at http://rafiqdossani.com ("There was a comforting belief that the nations receiving the work . . . were developing nations and their labor forces would remain largely 'hands' directed by managers and engineers from the developed world.").

84 USTR, "2010 National Trade Estimate Report" (March 31, 2010) at 69 ("2010 NTE China Report") (emphasis added).

While U.S. high-tech companies have expressed alarm over these plans,[85] recent Chinese revisions to its original proposals have failed to satisfy U.S. policymakers.[86]

Fifth, the potential size of China's economy is simply enormous. U.S. policymakers, perhaps blinded by China's long centuries of poverty, gave little attention to this fact. As recently as 1995, our trade deficit with China was only $33.8 billion – just over half the size of our trade deficit with Japan.[87] In 2000 China's total GDP ($1.2 trillion) meant that its economy was smaller than that of France ($1.33 trillion).[88] Under these circumstances, U.S. policymakers plainly underestimated the potential harm that could result from a poorly-designed trade agreement between the United States and China. As shown above, in 2000 a representative of the Cato Institute dismissed China's manufacturing exports to the United States as equal to one-half of our manufacturing imports from Mexico.[89]

But for much of history, China had the biggest economy in the world – and it is fully capable of regaining that title. Indeed, China is on pace to become the world's second largest economy (overtaking Japan) by the end of this year,[90] and may even become the world's largest economy (overtaking the United States) within a decade.[91]

Misjudging China's Role in the WTO. The WTO grew out of a series of trade agreements that began with the General Agreement on Tariff and Trade ("GATT") in 1947. For most of its history, the GATT was dominated by relatively wealthy countries that agreed on basic principles of democracy and capitalism.[92] In fact, many officials involved in the establishment of GATT

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85 *See* Andrew Browne and Loretta Chao, "U.S. Firms Feel Shut Out in China," *The Wall Street Journal* (March 22, 2010) ("A growing number of U.S. companies feel unwelcome in China, according to a new survey by the American Chamber of Commerce in China, as measures aimed at squeezing foreign technology companies out of the vast government-procurement market start to bite.")

86 Doug Palmer and Lucy Hornby, "U.S. still concerned on China innovation rules," *Reuters* (May 25, 2010) ("The United States is concerned that China's revised proposals to promote innovation will still discriminate against American firms, U.S. Trade Representative Ron Kirk said on Tuesday.")

87 *See* U.S. Trade in Goods (Imports, Exports and Balance) by Country, available at http://www.census.gov.

88 *See* World Bank Group Data Bank (Series = GDP), available at http://www.databank.worldbank.org.

89 For the record, it should be noted that in 2009, U.S. imports of manufactured goods from China ($289 billion) were almost twice the total of manufactured imports from Canada ($150 billion) – the second-largest source of such imports. (Mexico was the third-largest source of manufactured imports, with a value of $140 billion. *See* Trade Stats Express, Office of Trade and Industry Information, U.S. Department of Commerce, available at http://tse.export.gov.

90 Edward Wong, "China on Path to Become Second-Largest Economy, *New York Times* (Jan. 21, 2010).

91 Scott Murdoch, "China to surpass US 'within a decade'," *The Wall Street Journal* (Aug. 24, 2009).

92 *See* Francine McKenzie, "GATT and the Cold War: Accession Debates, Institutional Development, and the Western Alliance, 1947-1959" *Journal of Cold War Studies* (Apr. 13, 2010) at 79 (describing the "link between GATT and liberal capitalist democracies.")

did not want communist nations such as the Soviet Union to join GATT because they thought such countries would sabotage GATT's effectiveness.[93] Indeed, the experience of the Cold War – in which international relations became polarized between democratic and capitalist nations, on the one hand, and authoritarian and communist nations, on the other – solidified GATT as a "pillar of the free world."[94] The United States and its allies generally extended GATT membership to countries that they were intent on anchoring to the alliance of democratic and capitalist nations.[95]

Against this background, it is clear that allowing a huge non-market economy like China – a country that practices neither democracy nor true market capitalism – to enter the WTO had profound consequences for that organization. Indeed, growing tensions between capitalist countries like the United States and mercantilist countries like China could significantly undermine the effectiveness of the WTO. Clyde Prestowitz, President of the Economic Strategy Institute, recently made this point in testimony before House Ways and Means Committee:

> We've all been engaging in a huge charade. We in the United States have been acting on the basis of the presumption that in a world of globalization, with a majority of countries being IMF and WTO members, that all countries are playing the same globalization game. And that it is a game of win-win free trade. This has never been true and is increasingly less true. In fact, the world is divided – some important countries (the U.S., the UK, a few others) are more or less free traders, but many other countries are neo-mercantilists pursuing export-led growth strategies guided by elaborate industrial policies. . . . Can we really have deep economic integration between authoritarian, strategically guided economies and democratic/laissez faire economies?[96]

U.S. policymakers also underestimated China's ability to manipulate the WTO system to its own advantage. Based on his experience in China, James McGregor has stated that "Chinese policymakers are masters of creative initiatives that slide through the loopholes of WTO and other international trade rules."[97] Two such loopholes merit particular attention.

First, China engages in currency manipulation – a major form of trade protectionism not explicitly prohibited under the WTO agreements. Paul Krugman recently explained how China boosts exports and blocks imports by keeping the value of its currency (known as the "renminbi" or the "yuan") artificially low:

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[93] *Id.* at 85.

[94] *Id.* at 106-107 (internal quotations omitted).

[95] *Id.* at 107. For example, extending GATT membership to Japan in 1955 "was one way to demonstrate that Japan was rehabilitated and trusted by the democratic capitalist countries of the world." *Id.* at 93.

[96] Testimony of Clyde Prestowitz, Before the Committee on House Ways and Means (Mar. 24, 2010) at 2.

[97] Time to rethink relations at 1.

> Here's how it works: Unlike the dollar, the euro or the yen, whose values fluctuate freely, China's currency is pegged by official policy at about 6.8 yuan to the dollar. At this exchange rate, Chinese manufacturing has a large cost advantage over its rivals, leading to huge trade surpluses.
>
> Under normal circumstances, the inflow of dollars from those surpluses would push up the value of China's currency, unless it was offset by private investors heading the other way. And private investors are trying to get into China, not out of it. But China's government restricts capital inflows, even as it buys up dollars and parks them abroad, adding to a $2 trillion-plus hoard of foreign exchange reserves.[98]

C. Fred Bergsten, Director of the Peterson Institute for International Economics, recently testified before the House Ways and Means Committee that the yuan is undervalued by about 25 percent on a trade-weighted basis and by about 40 percent against the dollar.[99] Mr. Bergsten made clear that "*{the} competitive undervaluation of the renminbi is a blatant form of protectionism.* It subsidizes all Chinese exports by the amount of the misalignment, about 25-40 percent. It equates to a tariff of like magnitude of all Chinese imports, sharply discouraging purchases from other countries."[100]

Second, China takes advantage of WTO rules relating to value-added taxes ("VAT"). China imposes a VAT of 13 to 17 percent on most goods.[101] WTO rules allow China to impose this VAT on imports from other countries, such as the United States, and to rebate the VAT on Chinese exports.[102] While these rules apply to all WTO members,[103] China aggressively uses them to manipulate trade. By raising or lowering the VAT rebate available upon export, China causes companies to shift production to specific items that China wants to encourage, and away from other items that China wants to discourage. USTR reports that "these practices have caused

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[98] Chinese New Year at 1.

[99] C. Fred Bergsten, "Correcting the Chinese Exchange Rate: An Action Plan," Testimony before the Ways and Means Committee of the U.S. House of Representatives (March 24, 2010) ("Correcting the Exchange Rate"), available at http://www.piie.com. According to Mr. Bergsten, China is buying $1 billion each day in the exchange markets to prevent its currency from rising. *Id.*

[100] *Id.* (emphasis in original). Mr. Bergsten also pointed out that "{s}everal neighboring Asian countries of considerable economic significance – Hong Kong, Malaysia, Singapore, and Taiwan – maintain currency undervaluations of roughly the same magnitude in order to avoid losing competitive position to China." *Id.*

[101] 2010 NTE China Report at 9.

[102] *Id.*

[103] It should be noted that WTO rules prohibit the United States from rebating the income tax charged on U.S. exports, or from imposing such a tax on Chinese imports. As a result, U.S. exports to China are taxed twice (once by U.S. income tax and then by China's VAT), while Chinese exports to the United States face neither the U.S. income tax nor the Chinese VAT. The unequal treatment of VAT and income taxes under international trading rules plainly puts U.S. companies at a disadvantage vis-a-vis their Chinese counterparts – another factor overlooked by PNTR supporters.

tremendous disruption, uncertainty, and unfairness in the global markets for some products, particularly ones for which China is a leading world producer or exporter such as steel."[104]

Misjudging Incentives for Industries to Shift Production Wholesale to China and then Ship Back to the United States. In analyzing the likely impact of PNTR, supporters tended to focus narrowly on the formal trade barriers between the United States and China. Their view can be summarized by a Cato publication stating that "{a}s the U.S. market is already largely open to Chinese imports, *it is primarily U.S. exporters who will benefit.*"[105] In other words, supporters assumed that since the United States had been granting MFN status to China for decades, granting MFN on a permanent basis would make no significant difference to how companies would serve this market.

But this assumption failed to account for the many incentives Western companies had to bet on the other side, and use China as a manufacturing platform to serve the U.S. market. As shown throughout this paper, China practices numerous forms of mercantilism – including subsidies, currency manipulation, and government programs that encourage developing new products in China – that give companies strong reasons to move production to that country. China's relatively weak labor and environmental policies have a similar effect. China also manipulates raw material markets in a manner that encourages manufacturers to move there. For example, chemical manufacturers are "rushing to expand production in China" after the Chinese government imposed prohibitive export tax that quadrupled the price of yellow phosphorous, a crucial raw material for more than 2,000 phosphorous-based chemicals.[106]

Prior to PNTR, there were strong reasons for Western companies to hesitate before taking advantage of the incentives offered by China. Congress might overturn the annual Jackson-Vanik waiver with respect to MFN. The United States might use its broad powers under Section 301 of the Trade Act of 1974 ("Section 301"), discussed in more detail below, to crack down on unfair trading practices in China. Large-scale outsourcing might lead to more aggressive U.S. action with respect to Chinese imports. After PNTR, however, the situation was very different. Western companies could be confident that even if they shifted most – or even all – of their production to China, they would still have virtually unlimited access to the U.S. market. Indeed, even those companies that wanted to stay here had to worry about the possibility that their competitors would move to China. These incentives soon had a major impact on U.S.-China trade. By 2007 *Forbes* magazine was reporting that "{a} large portion of the frighteningly lopsided U.S.-China trade deficit *can be traced to goods made by Western companies in China, then shipped home for sale.*"[107]

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[104] 2009 USTR Report at 7.

[105] Groombridge Article at 1 (emphasis added).

[106] Foreign Companies Chafe at Restrictions at 1.

[107] Robyn Meredith, "Made by America in China (Book Excerpt)" *Forbes* (July 25, 2007), available at http://www.forbes.com (emphasis added).

Forfeiting Leverage Over China. Prior to PNTR, the annual waiver of Jackson-Vanik by the President provided a system of checks and balances with respect to China's trade policies. China knew that if it implemented trade-distorting policies that significantly harmed the U.S. economy, the U.S. could withdraw China's most-favored-nation status. By granting PNTR, however, the United States forfeited this critical leverage.

We also forfeited our ability to take effective action against China under Section 301,[108] which provides authority for USTR to take unilateral actions where it determines that a foreign country is denying U.S. rights under a trade agreement or is otherwise engaging in unjustifiable practices that restrict or burden U.S. commerce.[109] During the 1980s and early 1990s, the United States used Section 301 extensively to induce appropriate trade behavior from other countries where the multilateral GATT system was not addressing its concerns.[110] In 1994, however, as part of the Uruguay Round Agreement that transformed the GATT into the WTO, the United States effectively gave up most of its ability to use Section 301 against other WTO members in exchange for the ability to use the WTO dispute settlement mechanism instead.[111]

Unfortunately, U.S. policymakers significantly over-estimated the effectiveness of the WTO dispute settlement process. By contrast to Section 301 – which was a powerful tool with which to influence our trading partners – the dispute settlement process is simply not designed to deal

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108 *See* Trade Act of 1974, Pub. L. No. 93-618, 301-02, 88 Stat. 1978, 2041-43 (1975) (codified as amended at 19 U.S.C. § 2411).

109 *See id.* As the legislative history of the Trade Act of 1974 makes clear, the original purpose of Section 301 was to empower the executive branch to take decisive action when it was otherwise unable to protect U.S. interests:

> "The President ought to be able to act or threaten to act under section 301, whether or not such action would be entirely consistent with the General Agreement on Tariffs and Trade... . The decision-making process under the General Agreement often frustrates the ability of the United States ... to obtain the decisions needed to enable the United States to protect its rights and benefits under GATT. ... The Committee felt it was necessary to make it clear that the President could act to protect U.S. economic interests whether or not such action was consistent with the articles of an outmoded international agreement."

S. Rep. No. 93-1298, at 166 (1974), reprinted in 1974 U.S.C.C.A.N. 7186, 7304.

110 *See generally* C. O'Neal Taylor, "The Limits of Economic Power: Section 301 and the World Trade Organization Dispute Settlement System," 30 Vand. J. Transnat'l L. 209 (1997).

111 Specifically, as part of the Uruguay Round Agreement Act, Section 301 was amended so that USTR was not required to take action where a WTO dispute settlement body has found that the rights of the United States are not being violated. *See* 19 U.S.C. 2411(a)(2)(A) (2006). In addition, during a case before the WTO, the United States stated that it would not conduct a Section 301 investigation in such a manner as to unilaterally determine whether another country is violating a WTO Agreement, and based on this position, the WTO panel approved Section 301 actions as being consistent with the WTO dispute resolution scheme. *See* Panel Report, United States--Sections 301-310 of the Trade Act of 1974, PP 7.71-.94, WT/DS152/R (Dec. 22, 1999) at ¶ 7.159. As a result, it is now widely recognized that a Section 301 petition "is simply a method of forcing the USTR to consider initiating a dispute proceeding against another country in the WTO." *See* Claire Wright, "Hollywood's Disappearing Act: International Trade Remedies to Bring Hollywood Home," 39 Akron L. Rev. 739, 816 (2006).

with a country like China. WTO cases are "costly and time-consuming,"[112] and in many instances they must be industry specific.[113] As a result, the United States might have to bring multiple cases to address the same trade-distorting policies that pervade multiple industries throughout China. Indeed, WTO cases are not well-suited to dealing with broad policy issues:

> Tackling the systemic trade imbalances between China and the United States through WTO mechanisms will not address broader issues such as environmental pollution or workers' rights abuses. The U.S. government will have to find alternative venues in which to address such matters.[114]

Moreover, even when the United States wins a WTO case, that does not guarantee that China will comply with its WTO obligations.[115]

A Passive Response from the U.S. Government. Supporters of PNTR seemed to assume that the U.S. government would act aggressively to ensure that China fully complied with its WTO obligations. But this has not happened. While China pursues aggressive mercantilist practices that have severely damaged the U.S. economy, the response of the U.S. government has been remarkably passive.

For example, as part of its WTO accession, China agreed that for 12 years other members could impose China-specific safeguard measures in response to import surges.[116] As discussed above, President Clinton specifically identified this provision – found at Section 421 of the Trade Act of 1974, as amended – as a major reason PNTR was a good deal for the United States. Between 2002 and 2005, the U.S. International Trade Commission ("ITC") heard four cases in which it determined that the requirements for a China-specific safeguard had been met.[117] In every case,

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[112] Phoenix X. F. Cai, "Think Big and Ignore the Law: U.S. Corn and Ethanol Subsidies and WTO Law," 40 Geo. J. Int'l L. 865, 911 (2009).

[113] *See, e.g.*, World Trade Organization, Agreement on Subsidies and Countervailing Measures: Structure of the Agreement (explaining that the WTO Agreement on Subsidies and Countervailing Measures "applies only to subsidies that are specifically provided to an enterprise or industry or group of enterprises or industries"), *available at* http://www.wto.org.

[114] U.S.-China Economic and Security Review Commission, "2009 Report to Congress" (November 2009) at 79 (emphasis added).

[115] *See* Pei-kan Yang, "Some Thoughts on a Feasible Operation of Monetary Compensation as an Alternative to Current Remedies in the WTO Dispute Settlement," 3 Asian J. WTO & Int'l Health L. & Pol'y 423, 423 (stating that "a close examination of current WTO remedies has . . . point{ed} out a variety of potential shortcomings such as ineffective compliance, inadequate remedies and inequitable consequences of retaliation.")

[116] *See* World Trade Organization, *Protocol on the Accession of the People's Republic of China*, WT/L/432 (Nov. 10, 2001) (hereinafter "China Protocol of Accession") at 16.

[117] *See Pedestal Actuators from China*, Inv. No. TA-421-1 (Determination), USITC Pub. 3557 (Nov. 2002); *Certain Steel Wire Garment Hangers from China*, Inv. No. TA-421-2 (Determination), USITC Pub. 3575 (Feb. 2003); *Certain Ductile Iron Waterworks Fittings from China*, Inv. No. TA-421-4 (Determination), USITC Pub. 3657 (Dec. 2003); *Circular Welded Non-alloy Steel Pipe from China*, Inv. No. TA-421-6 (Determination), USITC Pub. 3807 (Oct. 2005).

however, the Bush Administration exercised its discretion to deny relief – effectively rendering Section 421 a dead letter. Indeed, after 2005 U.S. companies stopped even applying for safeguard measures from the Bush Administration. Thus, for much of the time that Section 421 was supposed to be available to U.S. companies, the U.S. government refused to provide any relief.[118]

The United States has also done very little in response to Chinese currency manipulation. As early as July 2003, Representative Donald Manzullo (R-Ill.) stated that that "{i}t is time for the U.S. government to get serious with countries who tamper with their currencies to give their companies an unfair advantage over U.S. manufacturers" and that such manipulation represented "obvious violations of the World Trade Organization and International Monetary Fund."[119] Yet despite frequent pleas to address China's currency manipulation, the United States has refused even to label China as a currency manipulator. Indeed, U.S. Treasury Secretary Geithner recently announced that, rather than stating whether China manipulates its currency in a semiannual report to Congress on the currency practices of key trading partners, he would delay the report to avoid a potential controversy that could overshadow meetings between U.S. and Chinese officials.[120]

Hubris About the Triumph of Democratic Capitalism. Finally, it is important to remember that ten years ago – following the demise of the Soviet Union, the fall of the Berlin Wall, and nearly two decades of relatively strong economic performance – U.S. policymakers had a profound confidence in the ultimate triumph of democracy and capitalism. As early as 1989, for example, Francis Fukuyama, deputy director of the State Department's policy planning staff, wrote a widely-circulated essay entitled "The End of History." In it, he argued that the world was witnessing "the total exhaustion of viable systematic alternatives to Western liberalism" as well as "the end of history as such: that is, the end point of mankind's ideological evolution and the universalization of Western liberal democracy as the final form of human government."[121] By 1999, when the debate on PNTR began, many Americans took for granted that the rise of

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[118] In 2009, the Obama administration did grant safeguard relief with respect to tire imports. Bloomberg Business Week, "Obama's Tire Tariff Draws Beijing's Ire" (Sept. 13, 2009), *available at* http://www.businessweek.com/globalbiz/content/sept2009/gb20090913_714101.htm. Although this relief was clearly appropriate under WTO rules – in fact, China had specifically agreed to subject itself to such relief in order to gain PNTR – China responded by threatening to investigate allegations of U.S. unfair trade with respect to chicken and automobiles.

[119] Patrice Hill, "Asian currencies' edge in trade draws Hill ire," Washington Times (July 26, 2003).

[120] "U.S. delays report on alleged China currency manipulation" *CNN* (Apr. 4, 2010). The Omnibus Trade and Competitiveness Act of 1988 (the "Act") requires the Secretary of the Treasury to provide biannual reports on the international economic and exchange rate policies of the major trading partners of the United States. Under Section 3004 of the Act, the report must consider whether any foreign economy manipulates its rate of exchange against the U.S. dollar to prevent effective balance of payments adjustments or to gain unfair competitive advantage in international trade. *See* 22 U.S.C. § 5304 (2006). As explained in the text, Treasury has refused to designate China as a currency manipulator in this report. *See, e.g.*, U.S. Department of the Treasury, Office of International Affairs, "Report to Congress on International Economic and Exchange Rate Policies," (Apr. 15, 2009), available at http://www.ustreas.gov.

[121] Francis Fukuyama, "The End of History," The National Interest (1989).

democracy and capitalism "to global predominance was the crucial development of the millennium."[122]

This confidence – which can now be seen as hubris – encouraged many U.S. policymakers to believe that China would inevitably embrace democracy and capitalism. Indeed, some policymakers simply assumed that free trade and American power would go hand in hand. In December 2001, for example, Representative Tom Delay (R-Tex.) declared: "The continued triumph of American democracy and capitalism requires the expansion of international commerce to wherever the benefits of that activity will reach individual citizens."[123]

Over the last ten years, however, China's resurgence has discredited the notion that America knows best:

-- Between 2001 and 2009, the United States' nominal gross domestic product ("GDP") grew by 38.6 percent.[124] Over the same period, China's nominal GDP grew by *over 271 percent*.[125]

-- Between 2001 and 2009, total exports from the United States to the rest of the world grew by 45 percent.[126] Over the same period, China's total exports grew by *351 percent.*[127]

-- Between 2001 and 2009, the United States' trade deficit with the world rose from $398 billion to $418 billion – notwithstanding a decline in trade during 2009

[122] J.M. Haas, "Can Western Democracy Prevail?" St. Louis Post-Dispatch (Dec. 19, 1999). *See also* "Capitalism Wins. Now What?" Chicago Tribune (Jan. 4, 2000) (arguing that the 20th Century was just as much about the triumph of capitalism over socialism as it was the triumph of democracy over authoritarianism).

[123] Tom Delay, "Economic expansion via trade promotion; War on terror requires guns, butter . . . and free trade," The Washington Times (Dec. 6, 2001)

[124] The GDP of the United States grew from $10.286 trillion in 2001 to $14.256 trillion in 2009. *See* International Monetary Fund World Economic Outlook Database (April 2010). (14.256 – 10.286) / 10.286 = 0.386 = 38.6 %.

[125] China's GDP grew from $1.324 trillion in 2001 to $4.909 trillion in 2009. *See* International Monetary Fund World Economic Outlook Database (April 2010). GDP data for 2009 are estimated by the IMF staff. (4.909 – 1.324) / 1.324 = 2.708 = 270.8 %.

[126] The total exports of merchandise to the world by the United States were $729 billion in 2001 and $1.057 trillion in 2009. *See* Trade Stats Express, Office of Trade and Industry Information, U.S. Department of Commerce. (1,057 – 729) / 729 = 0.450 = 45.0 percent.

[127] The total exports of merchandise to the world by China were $266 billion in 2001 and $1.2 trillion in 2009. *See* US-China Trade Statistics and China's World Trade Statistics, available at http://www.uschina.org/statistics/tradetable.html (1,200 – 266) / 266 = 3.511= 351.1 percent.

> caused by the recent economic crisis.[128] Over the same time period, China's trade surplus with the world soared from $17 billion to $284 billion.[129]

In addition to this record of economic performance, there is also now a widespread belief that "{t}he humbling of Wall Street was proof that the American system was not invincible."[130] In fact, many investors are now placing their bets with China's economy instead of the American economy. As investment guru Jim Rogers explained when he moved to Singapore and began tutoring his daughter in Mandarin, "{i}f you were smart in 1807 you moved to London, if you were smart in 1907 you moved to New York City, and if you are smart in 2007 you move to Asia."[131]

Given these facts, it is hardly surprising that Chinese leaders believe that our system of free trade and open markets is failing. Multinational executives with operations in China have confirmed that this is exactly what Chinese policymakers are thinking:

> {S}evere recessions and the near collapse of banking systems in many Western countries a year ago, coupled with China's relatively robust economic performance, *have persuaded Chinese policy makers that Western policies of free trade and open markets do not work as well as previously thought, and that new industrial policies are worth trying.* They say, "Don't show us broken models; we're looking for a completely different way," and you see a much greater willingness to experiment with completely untested policies.[132]

One analyst has declared that the "free-market tide has now receded" and "{i}n its place has come state capitalism."[133]

VI. Where Do We Go From Here?

Many experts agree that our trading relationship with China presents a serious threat to our economy and the effective functioning of the WTO. How should U.S. policymakers respond to

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[128] *See* International Monetary Fund World Economic Outlook Database (April 2010). In 2008, before the full effects of the economic crisis were felt, the U.S. trade deficit was $696 billion. *See* World Bank Group Statistics.

[129] *See* International Monetary Fund World Economic Outlook Database (April 2010). The 2009 figure represents an estimate from the IMF Staff. Another source shows an increase in China's trade surplus from $23 billion in 2001 to $196 billion in 2009. *See* US-China Trade Statistics and China's World Trade Statistics, available at http://www.uschina.org/statistics/tradetable.html. Under either measure it is clear that China's trade surplus has soared since it joined the WTO.

[130] Sean O'Grady, "China will overtake America, the only question is when," The Independent (Oct. 6, 2009).

[131] "Jim Rogers moves to Singapore," CNNGo.com (Sept. 1, 2009).

[132] "Foreign Companies Chafe at China's Restrictions" (internal quotations omitted) (emphasis added).

[133] Capitalism Comes of Age at 2.

these problems? As described in more detail below, I believe they should stop being so passive, take a number of straightforward steps to mitigate the harm caused by Chinese mercantilism, and consider more imaginative steps to deal with China.

We must stop being so passive. For ten years now, U.S. policymakers have done very little as China pursued policies that have resulted in an enormous trade imbalance. This approach has not worked, and it is past time for the U.S. government to become more aggressive.

Supporters of a passive approach make four major arguments, none of which is persuasive. First, they contend that our current policy is showing progress.[134] But we have already waited ten years during which the distortions described in this paper have generally gotten worse, and we cannot afford to keep waiting. Furthermore, the U.S. government itself has indicated that China is moving *away* from market liberalization, not toward it.[135] Only last month the latest effort by the U.S. government to take a soft-line approach to China – during a Strategic Economic Dialogue meeting in Beijing – failed to make any significant progress toward addressing the problems identified in this paper.[136]

Second, we are told that China is a proud nation, and that pressure from the U.S. policymakers will make the current situation worse.[137] Given that the current situation is extremely grim, however, we should not assume that aggressive action on our part would automatically make the situation worse. Indeed, it is naive to insist that China decides major questions of trade policy on the basis of whether its leaders' feeling have been hurt; we should instead recognize that Chinese leaders will pursue actions that are in their interest. If we want China to adopt more market-friendly policies, we must show its leaders that it is in their interest to do so – even if that means making clear that remaining on the current path will have negative consequences.

Third, we are told that the United States needs China's help on a range of geopolitical issues, such as maintaining peace on the Korean peninsula or preventing Iran from obtaining nuclear

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[134] *See, e.g.*, Ian Talley, "Geithner: Welcome China's Commitment to New WTO Offer," *Dow Jones Newswires* (May 25, 2010), available at http://www.wsj.com (quoting Treasury Secretary Geithner as saying that "Quietly but surely, we {the United States and China} are building a very strong network of cooperative arrangements on a range of goals.")

[135] *See* "U.S., EU Take China to Task at WTO Over Slowdown in Trade, FDI Reforms," *BNA WTO Reporter* (June 2, 2010) (quoting U.S. ambassador to the WTO Michael Punke as stating that "In the United States' view, China has become much more focused on developing industrial policy initiatives aimed at helping Chinese enterprises move up the value chain in key industries, and China has demonstrated a highly selective interest in continuing to open its market more fully and fairly to foreign participation.") The EU's acting WTO ambassador recently commented that "our companies have reported a worsening of the business climate {in China}." *Id.*

[136] *See* John Pomfret, "U.S.-China talks end without accords on key issues," *Washington Post* (May 26, 2010), available at http://www.washingtonpost.com ("Before the talks started, U.S. officials played down the possibility of major breakthroughs – they spoke of their hope for 'solid singles, not home runs.' But even by those standards, the results of the two days of talks seemed thin.")

[137] *See, e.g.*, Mark Landler, "Currency Dispute Likely to Further Fray U.S.-China Ties," *The New York Times* (Feb. 3, 2010), available at http://www.nytimes.com (stating that "{c}riticizing China's {currency} policy, however, is likely to worsen a relationship already frayed by irritants on both sides.")

weapons.[138] But this claim is really an argument for allowing current trends to continue indefinitely; there will always be some type of crisis where we could use China's assistance. The key issue is not whether we want China's help, but whether any potential help we may receive is worth the harm caused by China's trade policies. Our trade deficit with China is itself a major crisis that has already done serious harm to our economy, and will continue to do so in the future. If we keep putting this crisis on the back burner, it will almost certainly grow even worse.

Fourth, we are told that the United States has very little leverage in this situation because we need China to keep purchasing U.S. treasury bills,[139] while China is not dependent on our market.[140] But China is not buying U.S. debt as part of an altruistic effort to help the U.S. economy. Those purchases are the inevitable result of China's desire to prevent the yuan from rising in value vis-a-vis the dollar – as market forces would otherwise require. Similarly, the notion that the United States can do nothing in response to Chinese mercantilism is exaggerated. As shown above, China's leaders place great importance on using exports to create the jobs on which Chinese stability depends. They have a strong incentive to avoid any conflict that could significantly reduce their shipments to this country.

There are straightforward steps that could make a significant difference. Assuming that U.S. policymakers are serious about addressing Chinese mercantilism, several measures should be taken at once.

First, we must aggressively enforce our trade laws, including our anti-dumping ("AD") and countervailing duty ("CVD") laws as well as the Section 421 safeguard provision. For American businesses and workers currently suffering harm from unfairly-traded Chinese imports, enforcement of the trade laws represents the most practical step to provide effective relief in the near term. At a minimum, therefore, we should:

- appoint officials at the Department of Commerce and the ITC who are committed to strictly enforcing our trade laws;

- continue to treat China as a non-market economy for purposes of the AD law;[141]

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[138] *See* Margaret Besheer, "Clinton Urges China to Cooperate on North Korea, Iran at Talks," *VOANews.com* (May 24, 2010).

[139] *See* "China's Role as Lender Alters Obama's Visit," *The New York Times* (Nov. 14, 2009), available at http://www.nytimes.com.

[140] *See* Andrew Batson, "China's Dependence on Exports, Revisited," *WSJ.com* (April 10, 2009), available at http://blogs.wsj.com.

[141] Under U.S. law, China is currently treated as a non-market economy for purposes of calculating dumping margins. Since prices in a non-market economy are unreliable, this designation allows the Department of Commerce to use price information from surrogate countries, such as India, to construct the value of imported products from China, thereby leading to more accurate dumping margins. *See generally* U.S. Government Accountability Office, "US-China Trade: Eliminating Nonmarket Economy Methodology Would Lower Antidumping Duties for Some Chinese Companies," Report No. GAO-06-231 (Jan. 2006).

- recognize that China's practice of currency manipulation constitutes a countervailable subsidy for purposes of our CVD law;

- provide strong and effective safeguard relief to industries that qualify for such relief under Section 421;

- implement measures designed to strengthen our trade laws;

- strongly resist efforts by other countries to attack our trade laws through the WTO dispute settlement process; and

- reject any new agreements that would weaken our trade laws.

Second, we should respond to China's currency manipulation. As mentioned above, the U.S. government should treat currency manipulation as a subsidy for purposes of our CVD law. In addition, the United States should officially designate China as a currency manipulator, challenge China's currency manipulation at the International Monetary Fund ("IMF"),[142] and bring a WTO case on the grounds that currency manipulation is a prohibited export subsidy.[143]

Third, we should bring additional cases at the WTO regarding China's failure to comply with its WTO obligations. As explained above, the WTO dispute settlement process is not designed to address the type of systemic non-compliance we see in China. Nevertheless, we should use that process as aggressively as possible. USTR has identified a number of areas – ranging from IPR to industrial policies to distribution services – in which China has not complied with its WTO obligations.[144] USTR should pursue WTO litigation with respect to all such examples of non-compliance. If necessary, Congress should give USTR additional resources to increase its ability to try and win new cases.

We must be willing to take a more imaginative approach. Unfortunately, the steps outlined above, may not be sufficient to resolve the current crisis. As shown throughout this paper, China presents a unique challenge to U.S. policymakers, and it may require a unique response.

For example, we should consider aggressive interpretations of WTO provisions that might help us deal with Chinese mercantilism. While a detailed analysis of specific provisions is beyond the

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[142] While the IMF could not force China to change its currency policy, it could put pressure on China by entering into consultations on currency issues or by issuing a report criticizing China's exchange rate policy. *See* Correcting the Exchange Rage at 4.

[143] To the extent China's currency practice constitutes an export subsidy, it would violate several provisions of the WTO agreements, including the Agreement on Subsidies and Countervailing Measures as well as Articles VI and XVI of the GATT. *See generally* Petition for Relief Under Section 301(a) of the Trade Act of 1974, as amended, on Behalf of the China Currency Coalition (Sept. 9, 2004), available at http://www.chinacurrencycoalition.org (hereafter "China Currency Petition").

[144] *See generally* 2009 USTR Report at 4-10.

scope of this paper, it seems clear that a number of provisions could be relevant to the problems we face. Here are three examples.

Article XII of the GATT provides that, so long as certain requirements are met, "any contracting party, in order to safeguard its external financial position and its balance of payments, may restrict the quantity or value of merchandise permitted to be imported."[145] The United States invoked this provision in 1971 to impose a temporary import surcharge after its trade surplus deteriorated into a deficit.[146] Indeed, we took this step as part of a package designed to deal with an overvaluation of the dollar.[147] Now, of course, we face another situation in which the dollar is overvalued, the external financial position of the United States has significantly deteriorated, and there is widespread agreement that the imbalance represented by our trade deficit is disrupting the global economy. In light of these facts, U.S. policymakers should consider whether some type of action under Article XII is necessary to address our trade deficit. It should be noted, however, that Article XII does not appear to anticipate measures aimed at only one country, such as China. This provision, therefore, may be of limited assistance in addressing Sino-American issues.

Article XV of the GATT, entitled "Exchange Agreements," states that "{c}ontracting parties shall not, by exchange action, frustrate the intent of the provisions of this Agreement."[148] Traditionally, the term "exchange agreements" was seen as referring (as it did when the GATT was created in 1947) to "currency controls, exchange licenses, transaction taxes and other official actions that limit a potential purchaser's ability to get the foreign exchange needed to purchase goods from abroad."[149] In recent years, however, the IMF has broadened the meaning of this term, using it the context of whether a currency will float in value or be pegged to another currency.[150] Some have suggested that this provision could now be used to challenge China's currency regime:

> There has never been a definitive ruling by the GATT or the WTO on the meaning of Article XV, including how provisions of the GATT agreement might be frustrated by exchange action. Some might argue that currency undervaluation raises the price of imports in a way that unilaterally rescinds tariff concessions approved during multilateral trade talks.

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145 GATT Article XII.

146 *See* Robert E. Scott, "Re-Balancing U.S. Trade and Capital Accounts: An analysis of Warren Buffett's import certificate plan," *EPI Working Paper # 286* (Dec. 2009) at 2, available at http://www.epi.org.

147 *See generally* Claudia J. Dumas, "Suspending the Investment Tax Credit: The 'Tolerance of International Cartels' Standard," 17 Cornell Int'l L. J. 161, 169-170 (1984).

148 GATT Article XV:4.

149 Jonathan E. Sanford, "Currency Manipulation: The IMF and WTO," *CRS Report for Congress* (Jan. 26, 2010).

150 *Id.*

> Accordingly, a case could be made that the WTO should use the broader meaning of the term "exchange arrangements" and take currency valuation arrangements into account in its dispute settlement process. There has also been increased interest, in recent years, in the issue of currency manipulation and its impact on world trade and financial relationships. It could be argued, therefore, that this might be an appropriate and perhaps auspicious moment for issues relating to the trade impact of currency manipulation to be raised in the WTO dispute adjudication process.[151]

Of course, it is not clear that "winning" a case at the WTO would actually have a significant impact on China's currency policy. China would undoubtedly spend years resisting efforts to persuade it to comply with such a ruling – just as it already resists calls to comply with its other WTO obligations.

Article XXIII of the GATT states that "{i}f any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired . . . as the result of . . . the failure of another contracting party to carry out its obligations," then the contracting party may make proposals to the other relevant party or parties to resolve the issue. If the parties cannot resolve the issue satisfactorily, then the complaining party may seek permission "to suspend the application to any other contracting party or parties of such concessions or other obligations under this Agreement as they determine to be appropriate in the circumstances." Some have suggested that this provision might serve as the basis for a sweeping challenge to China's system:

> A complaint based on this argument might proceed as follows: When China joined the WTO, Chinese leaders agreed to enforce their laws and provide duty-free access for our products such as iPods or Heineken beers. We anticipated that you would respect international standards (for consumer safety, product safety or workers rights, for example). But a wide range of observers – Chinese and foreign – have carefully researched Chinese practices and have reported that Chinese officials ignore both international and local laws in factories that produce for export (such as those that supply foreign companies) as well as Chinese factories that compete with Apple or Heineken. Thus, your country has violated these non-WTO rules, and in so doing has impeded our access to markets; thus, we are requesting compensation for the value of that lost access.[152]

Of course, we cannot be certain that the WTO would adopt any of these theories – or that, if adopted, they would make a significant difference in China's behavior in the foreseeable future. But to attack a problem as large as our trade deficit with China, U.S. officials must be prepared, at a minimum, to consider very aggressive positions at the WTO.

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151 *Id.*; *see also* China Currency Petition at 71-74 (arguing that Chinese currency manipulation violates GATT Article XV:4).

152 Is China Killing the WTO? at 67.

Indeed, I would take the argument even further. Trade policy discussions in the United States have increasingly been dominated by arcane disputations about whether various actions would be "WTO-consistent" – treating this as a mantra of almost religious or moral significance. The fact is that the WTO is built upon a framework of mutual concessions and purported mutual benefits from expanded trade and open markets. WTO commitments are not religious obligations, do not (and should not be construed to) impinge upon national sovereignty, and are not subject to coercion by some WTO police force. Viewing them as such – and implicitly establishing this viewpoint as the inviolate touchstone of all U.S. trade policy – is at odds with the structure of the WTO itself, not to mention the vociferous and repeated statements made by proponents of the WTO when it was established.

In this regard, WTO commitments represent mutually beneficial, market-opening stipulations by individual countries. Where a country fails to fully implement commitments it has made, other countries are given the right to reciprocally suspend market-opening commitments of their own – in an amount precisely equivalent to, and no greater than, the value of trade they have lost as a result of the derogation that has occurred. In this way, the entire WTO system is in a very real sense *premised* upon the assumption of relatively equal costs and benefits among and between WTO participants – whereby compliance with WTO norms is encouraged by the knowledge that derogations will result in the suspension of equivalent trade concessions. Where this relationship does not hold – that is, where a trade relationship has become so unbalanced that the threat of retaliation pales in comparison to the potential benefits of derogation – it only makes sense that a sovereign nation would consider what options are in its own national interest (up to and including potential derogation from WTO stipulations).

This need not be seen as some fundamental threat to the integrity of the WTO system. Indeed, let me state explicitly that I am not advocating that the United States leave the WTO – that body is too important to us and the global trading system. I am merely pointing out that derogation may be a common sense, economically rational analysis by participants in the system – whereby potential decisions to derogate from WTO rules give rise to compensatory rights of other parties *within* the system.

Indeed, such an approach is plainly anticipated by the WTO agreements and has been acknowledged by U.S. policymakers. Properly understood, WTO rules do not infringe on the ability of individual nations to make their own sovereign decisions about economic policies – subject to the rights and obligations that flow from the WTO agreements themselves and any derogation of those agreements.[153] In this regard, U.S. officials have consistently stated that

[153] At least one writer has argued that an adopted dispute settlement report at the WTO establishes "an international law obligation upon the member in question to change its practice to make it consistent with the rules of the WTO Agreement and its annexes." John H. Jackson, "International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or Option to 'Buy Out'?" 98 Am. J. Int'l L. 109 (2004). The better view – not to mention the practical and legal reality reflected in the WTO structure itself – is that "WTO law is not like the international law proscription of genocide or aggressive war: It does not normatively demand compliance at all costs. Rather, WTO law is better understood largely as instrumental law that is only worthy of compliance to the extent that compliance makes people better off." Joel P. Trachtman, "The WTO Cathedral," 43 Stan. J. Int'l L. 127 (2007). Indeed, some have suggested that the WTO compliance system is best understood through an economic theory that encourages member states to engage in an "efficient breach" if the costs of compliance

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WTO commitments do not interfere with our national sovereignty, and that WTO rulings cannot alter U.S. law. These points were made repeatedly by Members of Congress during the debate over whether the United States should join the WTO.[154] Furthermore, USTR has plainly stated that WTO legal panels "have no authority to change U.S. law or to require the United States or any state or local government to change its laws or decisions."[155] USTR has specifically explained that other countries cannot force the United States to comply with WTO law; instead, their only available response is to retaliate by withdrawing trade benefits:

> If, ultimately, the United States cannot reach an agreed settlement with the country that brings a dispute settlement claim, that country may withdraw trade benefits of equivalent effect. However, *under trade agreement rules, the United States retains complete sovereignty in its decision of how to respond to any panel decision against it.*[156]

These statements are consistent with the WTO Dispute Settlement Understanding ("DSU"), which governs claims by one member that another has violated its obligations. Article 22(2) of the DSU provides that if a WTO member does not comply with a dispute settlement decision, and no satisfactory compensation can be agreed to, then the party that brought the dispute settlement case may request authorization to suspend trade concessions made to the non-complying member. Article 22(4) provides that "{t}he level of the suspension of concessions or other obligations authorized . . . shall be equivalent to the level of the nullification or impairment." In other words, "the provisions of the DSU, taken as a whole, allow a violator to continue a violation in perpetuity, as long as it compensates or is willing to bear the costs of the retaliatory suspension of concessions."[157]

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outweigh the benefits of compliance. *See generally* Warren F. Schwartz and Alan O. Sykes, "The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization," 31 J. Legal Stud. 179 (2002).

154 *See, e.g.* Statement of Sen. Pete Dominici (R-N.M.), 140 Cong. Rec. S15271-03, S15274 (Dec. 1, 1994) ("All living Presidents, former Secretaries of State, all former Trade Representatives of the United States, as well as many constitutional scholars, including Robert Bork, are convinced that this agreement does not impede U.S. sovereignty."); Statement of Sen. Christopher Bond (R-Mo.), 140 Cong. Rec. S15271-03, S15307 (Dec. 1, 1994) ("Congress has put the world on notice that we will monitor the WTO like a hawk, and that we are prepared not to comply with an unfair ruling, or even to withdraw if necessary."); Remarks of Rep. Lee H. Hamilton (D-Ind.), 141 Cong. Rec. E2-01 (Jan. 4, 1995) ("{T}he WTO cannot change any U.S. laws or policies. Only Congress and the President can do that, and no WTO ruling has any standing in U.S. courts.")

155 USTR, "Trade Facts" (April 14, 2005), available at http://ustraderep.gov.

156 *Id.* (emphasis added).

157 Schwartz and Sykes, 31 J. Legal Stud. at 191 (arguing that "{i}f WTO members really wanted to make compliance with dispute resolution findings mandatory, they would have imposed some greater penalty for noncompliance to induce it."); *see also* Trachtman, 43 Stan. J. Int'l L. at 146 ("States that violate WTO law are not subject to enforceable specific performance-type remedies, nor do they experience any formal penalty for their violation beyond the potential authorization of withdrawal of equivalent concessions outside of the export subsidies context.")

In the context of U.S.-China trade – whereby the United States is consistently running trade deficits viewed by virtually all rational observers as catastrophic and unsustainable – it is certainly advisable to consider all options available. To the extent that the United States were to consider more dramatic action to address the problem – such as tariffs or quantitative limitations that would arguably derogate from WTO commitments – the prospect of reciprocal denial of trade benefits by China must of course be assessed. At some point, however – where goods imports from China exceed $300 billion while U.S. exports to China are below $70 billion – one must ask whether potential retaliation from China really would or could even remotely offset the benefits to the United States of more aggressive trade measures.

I do not raise this topic lightly or deny that such a course would give rise to serious questions and concerns – not least whether the prospect of heightened trade frictions would bring ancillary costs, whether third parties might themselves be prejudiced by (and retaliate against) U.S. actions vis-a-vis China, and so forth. The point is that an unthinking, simplistic and slavish dedication to the mantra of "WTO-consistency" – in the face of a trading relationship that is completely out of balance and that has grown increasingly divorced from *any* of the promises made when China entered the WTO – makes very little sense, and is plainly *not* dictated by our international obligations. Indeed, derogation may be the only way to force change in the system, to prompt China to truly live up to the letter and the spirit of its WTO obligations, and to put in place a sustainable and mutually-beneficial trade relationship.[158]

Of course, none of the policies I have suggested can be effective unless U.S. policymakers have the will to implement them in a strong and determined manner. For years, our economic position vis-a-vis China has deteriorated because U.S. policymakers have refused to take the inevitable risks associated with challenging Chinese mercantilism. As a result, we are now burdened with a trade imbalance that everyone agrees is unsustainable. Wringing our hands and hoping for the best is not the answer. We need strong leaders who are prepared to make tough decisions, and who will not be satisfied until this crisis has been resolved.

VII. Conclusion

The optimistic promises made at the time Congress approved PNTR have not been fulfilled. Years of passivity and drift among U.S. policymakers have allowed the U.S.-China trade deficit to grow to the point where is widely recognized as a major threat to our economy. Going forward, U.S. policymakers should take these problems more seriously, and should take a much more aggressive approach in dealing with China.

[158] Indeed, one could argue that in the context of a country like China – where systemic market distortions and lack of transparency render traditional WTO dispute settlement wholly insufficient to enforce true compliance – unilateral derogations by an aggrieved country may be the only mechanism to actually incentivize and promote market-opening.