International Seminar

WTO Membership and Foreign Trade Law Reform

Foreign Trade Administration and Law on Trade of Goods and Technology

Comments of

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Presented to

Ministry of Foreign Trade and Economic Cooperation
Asian Development Bank

Beijing, China

October 2001

Good afternoon. My name is John Magnus. I am a Washington, DC-based trade lawyer from the law firm Dewey Ballantine, and I have worked on WTO issues for many years. I am pleased to be here today to talk with you about how some of the key WTO rules will apply to China after accession. My talk will cover (1) some of the most basic WTO principles (such as tariff bindings and most-favored-nation treatment); (2) some of China's more complex WTO implementation issues (such as trading rights and purchasing by state-invested enterprises); (3) certain elements of the U.S. foreign trade regime; and (4) the draft import/export regulation recently circulated by MOFTEC.

In considering the WTO-consistency of Chinese measures, there are two main sources of obligations: the basic WTO rules, and China's accession package, whose commitments in some areas supplement the basic WTO rules. The accession package includes a Protocol of Accession, a Working Party Report, and of course the various schedules of commitments China has tabled in the market access negotiations.

I. SOME BASIC WTO PRINCIPLES

Tariff bindings: Probably the most basic WTO obligation is not to impose, on imported products, customs duties in excess of scheduled tariff bindings. This deceptively simple concept accounts for much of the success of the multilateral trading system in its first half-century.

China has made tariff commitments on thousands of items in the various chapters of the Harmonized Tariff Schedule. For example, China has agreed to phase out, in accordance with the Information Technology Agreement, its tariffs on information technology products such as semiconductors, semiconductor manufacturing equipment, computers, computer parts, software, and telecommunications equipment. The November 1999 U.S.-China bilateral agreement includes a pledge by China to implement the ITA fully by 2005. China's exports will, of course, have the benefit of other countries' commitments to little or no tariffs.

Non-tariff measures: Also subject to scheduled elimination in the WTO system are other (non-tariff) measures that directly or indirectly limit imports. These can be border measures such as import quotas, or licensing requirements. Another example would be local content schemes in which manufacturers are pressured to source parts and materials domestically, thereby discouraging the purchase of imported components. Localization pressures result in a distortion of procurement and harm the competitiveness of domestic producers as well as being a violation of WTO rules.

Non-discrimination: Articles I and III of the GATT set out rules of non-discrimination. Article I covers most-favored nation (MFN) treatment, and Article III covers national treatment.

The MFN obligation prohibits all Members, including China after accession, from favoring the products of one WTO Member over those of another, whether in the use of border measures (tariffs etc.) or internal regulatory measures that affect imports. Every

product imported by China from a WTO Member will be entitled to "treatment no less favorable" than the best treatment accorded to other like imports. China's products will likewise be entitled to MFN treatment in export markets around the world, including the United States (where we now refer to MFN as "normal trading relations").

While Article I addresses discrimination between imported products of different origins, Article III addresses discrimination between imported and competing domestic goods. The national treatment obligation prohibits WTO Members from favoring domestic products over imports, whether in the use of taxes or other internal measures that affect the success of products in the market place. After accession, every product imported by China from a WTO Member will be entitled to "treatment no less favorable" than the best treatment accorded to like or directly competitive domestic products.

Transparency: Another basic WTO obligation involves transparency -- keeping all market participants, including importers and foreign suppliers, fully apprised of the legal requirements that could affect their market place activities, and giving them the opportunity to comment as those requirements evolve. This is covered generally by GATT Art. X.

This is an area that may require considerable procedural changes within China that will be of significant benefit to Chinese economic development. An economy of China's size and complexity requires rules and procedures that are published regularly, and are not subject to differing interpretations by officials. China should move to a system featuring advance notice and comment on trade- and investment-related regulations, and ready availability of official interpretations (published judicial decisions and authoritative administrative statements). In the WTO accession talks, China has agreed to take such steps.

II. SOME MORE COMPLICATED WTO PRINCIPLES

State trading: Turning now to some of the more detailed issues, one key issue is the requirement under GATT Art. XVII that "state trading" enterprises (those with a legal monopoly on the import or export of certain items) must base their purchase or sales decisions on commercial considerations such as price, quality and availability. These rules will be important to China after accession, as will those on the similar-sounding topic of purchasing by state-invested enterprises.

Purchasing by state-invested enterprises: Another key issue is the rules governing purchases by state-invested enterprises. "State-invested" means enterprises wholly or partially owned by the Chinese central, provincial or local governments. State-invested enterprises are prominent in, for example, the electronics sector.

The concern here is that government officials not seek to encourage state-invested enterprises to purchase domestically. For the benefit of China's economic development and to avoid trade friction with China's trading partners, a key element is the pledge, in China’s WTO accession package, that state-invested enterprises will make purchases

based solely on commercial considerations. China has agreed that it will not influence these commercial decisions except in a WTO consistent manner.

Investment restrictions: It is in China's interest to promote foreign direct investment. Yet, a number of complex requirements exist for foreign-owned ventures, including a restrictive approval and registration system and a number of both official and informal "performance requirements." China has agreed that, upon accession, it will implement the WTO *Agreement on Trade-Related Investment Measures* (TRIMs), eliminate export performance and local content requirements on foreign investors, and only enforce laws related to the transfer of technology if they are in accordance with WTO rules. China also agreed that it will not condition investment or import approvals on performance requirements of any kind. Specifically:

- *Export performance requirements:* Foreign companies can no longer be pressed by the Chinese approval authorities to agree to export targets. While such rules have not always been enforced, a company could have been held legally accountable for noncompliance. Further, while 100% foreign ownership of manufacturing facilities is permitted in China, it appears that, under an unpublished policy applicable to the electronics industry, 100% of such a facility's output must currently normally be exported. In one case, Chinese authorities reportedly removed the export requirement from a contract, on condition that the applicant, a U.S. firm, agree to re-invest all profits earned from domestic sales. All of these types of arrangements would be contrary to the China's WTO commitments.

- *Local content requirements:* There would no longer be localization policies for parts and materials for products made in China. These are not technically legal requirements, yet firms have had to file localization plans with their foreign investment applications. The Chinese Government also has audited foreign firms to determine local content. Further, what qualifies as local content has been subject to many definitions. For example, importation via a Chinese distributor can qualify a part as "local." Chinese sectoral industrial policies also contain local content requirements. These measures will no longer be permitted after China's WTO accession.

- *Technology transfer requirements:* Ownership restrictions, export targets and local content rules have in some cases functioned not as strict legal obligations, but as negotiating levers used by government officials at both the national and sub-national level seeking to obtain transfer of technology from foreign firms. This can no longer occur after WTO accession.

Individually and collectively, these kinds of measures have a significant adverse competitive impact on foreign firms and also discourage the investment necessary to develop local Chinese industries on a commercially sound basis. Should China maintain such measures in the future, other countries would be permitted to limit access to their markets for China's products.

Trading and distribution rights: One of the most important changes in China's trade regime will be in the area of trading and distribution rights. The right to distribute and service goods within China will no longer be restricted, as China has agreed to phase in distribution rights within three years from accession. Foreign producers will be able distribute and provide after-sales service directly, increasing efficiency and removing as much as 10% in costs and adverse effects on service, inventory, and delivery. Inability to deal directly with end-users is a particular problem in industries where the design and development of products requires extensive contact between producers and end-users.

Also important are trading rights -- the legal right to import and export goods. These rights have been limited to certain designated enterprises, including certain foreign-invested firms, which can trade products they manufacture in China. Foreign firms doing business in China without such rights have had to conduct their business through firms that hold such privileges. Moreover, a foreign company generally could not directly sell or service end products, spare parts or components not made in China. China has committed to phase in trading rights for foreign firms (including semiconductor suppliers) within three years from accession. How this commitment is implemented will be important.

By increasing direct interaction between producers and buyers and reducing costs, the establishment of trading and distribution rights will decrease the opportunities and incentives to sell goods through indirect channels, including by smuggling.

Regional integration: WTO rules (GATT Art. XXIV and GATS Art. V) enable WTO Members to establish customs unions or free trade areas. The conditions for using this authority -- for example, the requirement that "substantially all trade" between the participants be liberalized -- are ambiguous and have given rise to disagreements among WTO Members. These factors may affect the ease with which China will be able to utilize the provisions on customs unions and FTAs.

III. U.S. TRADE REGIME

The outline for this seminar identified certain elements of the United States' trade regime and asked how WTO-consistency is ensured in the specified areas. I will briefly cover these items in the order raised by the seminar organizers.

By way of context, trade agreements normally have no direct effect in U.S. law, as they would if presented as "treaties" and ratified by the U.S. Senate. Instead, the custom followed for trade agreements is for the Congress to enact implementing bills which express approval of the international agreements while expressly denying them direct legal effect. This approach minimizes the role of courts in policing the U.S. Government's compliance with trade agreements. Rather than adding this responsibility to those already borne by the judiciary, the U.S. Government ensures compliance by promptly amending, just before new international obligations take effect, laws which violate, or require agencies to violate, those obligations. The content of an implementing bill represents the collective judgment of the Executive Branch and the Congress

concerning what statutory provisions and agency practices, if left unchanged, would breach the newly-minted international obligations.

Export regulation: U.S. national security laws prohibit the export of certain goods and technologies destined for certain countries and end-users. Proposed exports and re-exports of controlled products require a license application and approval from the U.S. Government. These controls are based on several statutory authorities including the Export Administration Act (dual-use or civilian products) and the Arms Export Control Act (defense products). The Trading with the Enemy Act and the International Emergency Economic Powers Act provide additional authority to the President to restrict exports to certain destinations, including embargoes on countries to which virtually no goods may be exported such as Cuba, Iran, Iraq and formerly North Korea. While GATT Article XI limits the use of export licenses or other means to restrict the exportation of goods to other WTO Members, U.S. export restrictions are considered WTO-consistent because of the national security exception in GATT Article XXI.[1]

Section 301: Section 301 of the Trade Act of 1974 gives the President broad authority to take action aimed at enforcing U.S. rights under trade agreements, and eliminating other countries' trade practices that are deemed "unreasonable" or "unjustifiable." For example, section 301 can serve as domestic authority to implement a suspension of concessions authorized by a WTO panel.

Section 301 gives the President authority to take both WTO-consistent and WTO-inconsistent actions, in his discretion. As a WTO panel confirmed in 1999, the presence of this authority does not itself put the United States in violation of WTO rules. The United States does not lightly decide, even in the service of increasing overseas market access for a U.S. industry, to breach its international obligations.

Safeguard law -- section 201: Section 201 of the Trade Act of 1974 is the United States' "global safeguard" law. It implements United States' right, under GATT Art. XIX and the WTO *Agreement on Safeguards*, to impose import relief as a way of facilitating positive adjustment by a domestic industry seriously injured by increased imports. Certain analytical methods used by the U.S. International Trade Commission in making "serious injury" determinations have recently been found in WTO dispute settlement cases to violate WTO standards. This occurred in the *Wheat Gluten* and *Lamb* cases. It is probable that in both cases, affirmative ITC determinations could have been re-issued, with modestly revised analysis, thereby achieving compliance with the standards set out in the DSB-adopted decisions. However, this was made unnecessary by the President's decision in both cases to remove import restraints in favor of other measures to assist a positive adjustment by the affected U.S. industries. The possible impact on future ITC determinations cannot be ascertained at this stage.

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[1] The United States also restricts, for short supply purposes, the export of domestically produced crude oil and domestically harvested logs. On the import side, the United States does not maintain a licensing regime for imports of high technology products, but uses quotas to limit imports of textiles, sugar and cheese, and also prohibits the import of tuna and shrimp products caught using methods that put other marine species at risk.

IV. PROPOSED MOFTEC IMPORT/EXPORT REGULATION

Shortly before this paper was finalized, the seminar organizers circulated a copy of MOFTEC's draft import/export regulation dated September 26, 2001 and requested preliminary reactions to it. The following reactions are just that -- preliminary. In general, the draft regulation is a mix of procedural rules and broad guidelines for China's trade policy. Some provisions give very specific guidance for implementation of trade measures (e.g., customs procedures and quota implementation) while others address broad trade policy principles (e.g., health- and environment-based trade restrictions).

Certain parts of the regulation implement China's right to maintain restrictive measures that qualify under GATT Arts. XX (General Exceptions) and XXI (Security Exceptions). Other parts, however, seem to authorize WTO-inconsistent actions. For example, Article 14 states that the government can restrict the import of goods "in order to establish or accelerate the establishment of a [particular industry]." Articles 52 and 54 contain authority to impose restrictions which would appear to lack any cover in the WTO rules. And Article 94, which provides for extra-favorable treatment of Chinese enterprises which actively resist foreign governments' application of trade remedy measures, could likewise give rise to WTO problems depending on how it is used. Overall, this draft is a useful first step but could benefit from some fine-tuning.

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I thank you for the opportunity to present my views, and would be pleased to answer any questions you may have.