

**ANY CHANGE TO CHINA'S  
NON-MARKET ECONOMY STATUS  
MUST BE BASED ON THE CRITERIA  
SPECIFIED UNDER U.S. ANTIDUMPING LAW**

*A POSITION PAPER*

**PREPARED FOR THE  
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**INTRODUCTION**

The following paper explores the statutory criteria that the current, or any subsequent, U.S. administration must consider and evaluate in deciding whether to change China's status as a non-market-economy country under U.S. antidumping law, an issue of importance to both China and the United States.

In accordance with China's WTO accession obligations and commitments, China has made significant reforms to its economic and trade regime. These changes are important and welcome. Nevertheless, China's economic system is still characterized by many distortions which produce false market signals and trade flows that are not reflective of a market-based system. China has assumed a place of major importance in the global trading system. Given this importance, as well as the U.S.' unprecedented bilateral trade deficit with China, the U.S. administration should require that China meet all of the criteria specified in the U.S. statute, and address the full array of its economic distortions, before being granted any change to its non-market economy status. The issue is not whether China is making changes to its economic system but whether the overall operation of the system has progressed to a point that market economy status is warranted.

**THE STATUTE**

The U.S. antidumping statute defines the term "non-market economy" and specifies factors that must be considered in making a non-market economy country determination:

**(18) Nonmarket economy country.**

**(A) In General.**

The term 'nonmarket economy country' means any foreign country that the administering authority determines does not operate on market principles of cost or pricing structures, so that sales of merchandise in such country do not reflect the fair value of the merchandise.

**(B) Factors to be considered.**

In making determinations under subparagraph (A) the administering authority shall take into account –

(i) the extent to which the currency of the foreign country is convertible into the currency of other countries;

(ii) the extent to which wage rates in the foreign country are determined by free bargaining between labor and management,

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- (iii) the extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country,
- (iv) the extent of government ownership or control of the means of production,
- (v) the extent of government control over the allocation of resources and over the price and output decisions of enterprises, and
- (vi) such other factors as the administering authority considers appropriate.

Section 771(18) of the Tariff Act of 1930, as amended; 19 U.S.C. § 1677(18).

The statute also states that any determination of NME country status “shall remain in effect until revoked by the administering authority” (*i.e.*, the Department of Commerce). *See* 19 U.S.C. § 1677(18)(C)(i). Thus, China’s NME country status must remain in effect until Commerce officially changes that status.

While the statute provides that a non-market economy country determination may be made at any time (19 U.S.C. § 1677(18)(C)(ii)), Commerce makes such determinations in the context of public proceedings, as James J. Jochum, the former Assistant Secretary for Import Administration of the U.S. Department of Commerce, noted regarding a potential change to China’s NME status:

Any decision to graduate China to market economy status, whenever that decision is made, must be made in the context of a formal, quasi-judicial proceeding in accordance with Section 771, subparagraph 18(b) of the Tariff Act of 1930, as amended, and would be based solely on facts in evidence placed on the administrative record of such proceeding. As in previous proceedings undertaken pursuant to this statute, the record would be developed from data and information gathered from expert third party sources such as the OECD and World Bank, as well as from comments received from interested parties and the public.

U.S. Department of Commerce, International Trade Administration, Import Administration, *Hearing before the US-China Joint Commission on Commerce and Trade Working Group on Structural Issues*, June 3, 2004 at 6-7.

**STATUTORY CRITERIA FOR MARKET ECONOMY STATUS**

**1. Currency convertibility -- 19 U.S.C. § 1677(18)(B)(i)**

The Chinese currency is technically convertible, but, in reality, it is not. China does not allow its currency to be used for import and export transactions and its temporary suspension of

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external convertibility of the yuan during the 1997 Asian financial crisis has not been lifted.<sup>1</sup> In addition, China's currency is not convertible for the purpose of a capital account transaction, such as capital exporting.<sup>2</sup>

Although China recently ended its currency's decade-long peg to the dollar, the yuan is still controlled by being subject to a restricted float, with the exchange rate determined by a basket of foreign currencies but not allowed to move more than 0.3 percent in either direction each day.<sup>3</sup> While China has revealed that the basket of foreign currencies includes primarily the dollar, euro, yen and Korean won, as well as the currencies of Singapore, Britain, Malaysia, Russia, Australia, Canada and Thailand, it did not indicate the weighting of each in valuing the yuan.<sup>4</sup> As a result of this move, the yuan has appreciated about 2%.<sup>5</sup> Yet, a large number of economists consider China's currency to be substantially undervalued by as much as 40% or more,<sup>6</sup> a condition that is highly market-distortive and which contributes to the U.S.-China trade imbalance. In effect, currency undervaluation reduces imports by imposing a hidden tax or duty on imports and subsidizes exports by making them artificially less expensive.

China's change in how it values its currency is a welcome development. However, the small movement in its currency to date suggests that further currency reforms are needed. The crucial market concern is whether China's system in fact permits the movement of its currency to reflect genuine underlying market forces.

In assessing the factor of currency convertibility, we suggest that appropriate benchmarks should include:

- whether China has removed its currency exchange controls;
- whether China has achieved a freely floating currency based on an appropriate basket of foreign currencies; and
- whether China's currency is valued at a level that approximates its underlying value vis-à-vis the U.S. dollar.

**2. Wages determined by free bargaining between labor and management  
-- 19 U.S.C. § 1677(18)(B)(ii)**

Labor costs can account for a significant part of the total costs of many manufactured and agricultural goods, as well as many services. Workers in countries with market economies

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<sup>1</sup> See Teruhiko Mano, Japan Times, July 28, 2003 (in the TRI column), available at [http://www.triltd.co.jp/English/JT\\_column/e\\_new\\_tri\\_colum2003\\_July28\\_e.htm](http://www.triltd.co.jp/English/JT_column/e_new_tri_colum2003_July28_e.htm)

<sup>2</sup> See Jian Yang and David J. Leatham, *Currency Convertibility and Linkage Between Chinese Official and Swap Market Exchange Rates*, Western Economic Association International, Vol.19, No. 3, July 2001, at 347.

<sup>3</sup> See *China Says It Will No Longer Peg Its Currency to the U.S. Dollar*, New York Times, July 21, 2005.

<sup>4</sup> See *China Reveals Composition of Currency Basket*, New York Times, August 10, 2005.

<sup>5</sup> *Id.*

<sup>6</sup> In 2000, the World Bank estimated that the yuan was undervalued by 75%. See Fair Currency Alliance, Chinese Currency Manipulation Fact Sheet (May 10, 2004).

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generally enjoy a variety of rights including those that the International Labour Organization has identified as internationally-recognized core principles:

- freedom of association and the effective recognition of the right to collective bargaining;
- freedom from forced labor;
- the effective abolition of child labor; and
- nondiscrimination in employment.

While China reports adherence to at least some of the core labor principles, in reality, China falls far short in meeting these standards. The extent of China's non-compliance with many primary core labor standards<sup>7</sup> are documented by both the U.S. government and NGO organizations. A common theme with respect to labor standards is China's failure to actually implement laws to support legal guarantees. For example, China issued a Social Accountability Standard (SA8000)<sup>8</sup> in 1998 ostensibly allowing companies to obtain SA8000 certification. This Standard requires companies to adhere to the following international labor and UN conventions:

- ILO 29 and 105 (Forced Labor);
- ILO 87 (Freedom of Association);
- ILO 98 (Right to Collective Bargaining);
- ILO 100 & 111 (Equal Pay for Equal Work; Discrimination) {note: these are also two of the three ILO conventions that China has ratified<sup>9</sup>};
- ILO 135 (Workers Representatives);
- ILO 138 & 146 (Minimum Age);
- ILO 155 & 164 (Occupational Safety and Health);
- ILO 159 (Vocational Rehabilitation/Disabled Persons);
- ILO 177 (Home Work);
- ILO 182 (Worst Forms of Child Labor) {note: also ratified by China};
- United Nations Convention on the Rights of the Child; and
- United Nations Convention to Eliminate All Forms of Discrimination Against Women.

Many of these standards, however, have not been implemented even when mandated by Chinese law and lack real meaning in the operation of the workplace, as demonstrated by the following observations by the U.S. State Department and others:

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<sup>7</sup> ILO Declaration of Fundamental Principles and Rights at Work, June 1998.

<sup>8</sup> Social Accountability International web site: <http://www.cepaa.org/SA8000/SA8000.htm>.

<sup>9</sup> International Labor Organization database of International Labor Standards at <http://www.ilo.org/ilolex/english/docs/declAS.htm>.

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- Freedom Of Association And The Right To Collective Bargaining
  - “The (Chinese) constitution provides for freedom of association. However, in practice, workers were not free to organize or join unions of their own choosing. The All-China Federation of Trade Unions (ACFU) which was controlled by the Communist Party and headed by a high level party official was the sole legal worker’s organization. The Trade Union law gives the ACFU control over the establishment of all subsidiary union organizations throughout the country including enterprise–level unions. The Trade Union Law also allows workers to decide whether to join official unions in their enterprises. There are no reports of repercussions for the small percentage of workers in the state-owned sector that had not joined. Independent Unions are illegal.”<sup>10</sup>
  - The freedom to strike, though allowed in law, is not allowed in practice. “[G]overnment treatment of worker rights as illegal demonstrations established that there was still no officially accepted right to strike. In addition, no other types of planned worker action were allowed.”<sup>11</sup>
  - Amnesty International reported numerous instances of workers protesting low wages, low or missing wages, corrupt management, illegal working conditions, industrial accidents and death, physical ill-treatment and other forms of exploitation and abuse. Such protests were generally deemed illegal, as are independent trade unions. Protestors have seen arrests, beatings, criminal charges such as “subversion” for revealing “state secrets” in response to their attempts to improve worker conditions.<sup>12</sup> This treatment of workers needs to be ended and its end documented by independent observers, as a simple change of law means little in China where the rule of law has not taken firm root. Presently, access for NGOs to monitor human rights in China is severely circumscribed.<sup>13</sup>
  - The ability of Chinese workers to relocate to better jobs is restricted because they require government approval to change their place of residence or workplace because of the system of household registration (“Huko”). While the system is being liberalized, it still exists and the government can, at its choosing, restrict movement of persons.<sup>14</sup> The registration system should be abolished to allow workers to change jobs freely. Restrictions on the right of workers to choose their employment are major impediments to the functioning of a market economy.

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<sup>10</sup> U.S. Department of State Country Report on China, 2003, February 25, 2004, p. 34.

<sup>11</sup> U.S. Department of State Country Report on China, 2003, February 25, 2004, p. 36.

<sup>12</sup> Testimony by T. Kumar, Advocacy/Director for Asia & Pacific, Amnesty International USA, September 11, 2003.

<sup>13</sup> U.S. Department of State Country Report on China, 2003, February 25, 2004, p. 3.

<sup>14</sup> U.S. Department of State Country Report on China, 2003, February 25, 2004, p.25.

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- Chinese respect for internationally recognized workers rights were below international norms and did not improve in 2003.<sup>15</sup>
- While Chinese labor law, aside from freedom of association and the right to collective bargaining generally follows ILO conventions, this is irrelevant since the government does not enforce the laws.<sup>16</sup>
- Elimination of Forced or Compulsory Labor
  - The (Chinese) government continued to deny internationally recognized worker rights, and forced labor in prison facilities remained a serious problem.<sup>17</sup>
  - In 2003, over 250,000 people were serving sentences, not subject to judicial review, in “reeducation through labor” camps. In April, inmate Zhang Bin was beaten to death in a reeducation through labor camp.<sup>18</sup>
- The Elimination Of Child Labor
  - Although Chinese law prohibits child labor, it has no comprehensive policy to eliminate it,<sup>19</sup> and there have been reports of death and injury among children working in factories, such as the deaths of 34 schoolgirls in a fireworks factory explosion.<sup>20</sup>
  - A Tulane University report identifies child labor as a major social problem in China, despite the Compulsory Education Law of the Chinese Constitution. The government sees child labor as one way to combat poverty and does little to enforce relevant laws.<sup>21</sup>
  - From July 28 to August 1, 2003, four fireworks plants exploded, killing at least two children, ages 15 and 4. A fire at a fireworks factory in 1992 killed 20 workers, most of whom were between 9 and 14 years of age.<sup>22</sup> In March 2001, another fireworks plant exploded, killing from 41-60 children.<sup>23</sup>
  - In 1999, the ILO adopted Convention 182, Eliminating the Worst Forms of Child Labor.

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<sup>15</sup> Congressional-Executive Commission on China, Annual Report, 2003, p. 23.

<sup>16</sup> Congressional-Executive Commission on China, Annual Report, 2003, p. 24.

<sup>17</sup> U.S. Department of State Country Report on China, 2003, February 25, 2004, p.3.

<sup>18</sup> U.S. Department of State Country Report on China, 2003, February 25, 2004, p. 2.

<sup>19</sup> U.S. Department of State Country Report on China, 2003, February 25, 2004, p.31.

<sup>20</sup> U.S. Department of Labor, Bureau of International Labor Affairs Report, <http://www.dol/ilab/medi/reports/iclp/sweat/china.htm>.

<sup>21</sup> Child Labor in China, <http://tulane.tcs.tulane.edu/~rouxbee/kids/99/china2.html>.

<sup>22</sup> U.S. Department of Labor, Bureau of International Labor Affairs Report, <http://www.dol/ilab/medi/reports/iclp/sweat/china.htm>.

<sup>23</sup> China Labour Bulletin, <http://www.china-labour.org.hk>.

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- The Elimination Of Discrimination In The Workplace
  - China does not implement its laws protecting women against discrimination, leaving women vulnerable to pervasive abuse, discrimination at home and in the workplace.<sup>24</sup>

Thus, in assessing the factor of freely-bargained wages between labor and management, we suggest that appropriate benchmarks should include:

- whether China has fully implemented ILO core labor standards and has made significant and measurable improvement in its human rights record.

**3. Joint ventures and other investments -- 19 U.S.C. § 1677(18)(B)(iii)**

In accordance with its WTO obligations and commitments, China has gradually expanded trading rights and the extent of foreign participation in joint ventures and other investments. Even though China has opened up investment opportunities since joining the WTO, it still maintains controls on investment through a Catalogue of investment guidelines that channels investment flows to areas that support national development objectives. China issued a new Catalogue of Foreign Investment in November 2004, which took effect on January 1, 2005 (replacing the April 2002 Catalogue). The Catalogue designates sectors in which foreign investment are *encouraged*, *restricted* or *prohibited*.

- “Encouraged” sectors include ones that could benefit from foreign assistance or technology, such as construction and operation of infrastructure facilities.
- “Restricted” sectors include those not in line with the needs of China’s national economic development; JVs are allowed but with Chinese controlling or majority stake.
- “Prohibited” sectors include:
  - National defense
  - News media and broadcast
  - Production of firearms
  - Mining and processing of radioactive minerals & rare earth metals
  - Production and development of genetically modified plant seeds.<sup>25</sup>

Thus, to an extent, China still maintains control over, and imposes restrictions on, foreign investment, both direct and in joint ventures.

In joining the WTO, China committed to eliminate the practice of requiring technology transfer as a condition for investment in China and to bring itself into compliance with WTO TRIMs obligations by the time of accession. Although China revised its laws and regulations

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<sup>24</sup> Congressional-Executive Commission on China, Annual Report, 2003, p. 42.

<sup>25</sup> USTR, *National Estimate of Foreign Trade Barriers* (2005); U.S. & Foreign Commercial Service and U.S. Dept. of State, *Doing Business in China: A Country Commercial Guide for U.S. Companies* (2005).

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concerning foreign-invested enterprises to meet WTO obligations and to eliminate investment requirements such as export performance, local content, and technology transfer, it has been reported that China has not fully implemented these changes. For example, USTR has noted that:

[S]ome measures continue to “encourage” technology transfer, without formally requiring it. U.S. companies are concerned that this “encouragement” will in practice amount to a “requirement” in many cases, particularly in light of the high degree of discretion provided to Chinese government officials when reviewing investment applications. In addition, according to U.S. companies, some Chinese government officials in 2003 still considered factors such as export performance and local content when deciding whether to approve an investment or to recommend approval of a loan from a Chinese policy bank, which is often essential to the success of an investment project.<sup>26</sup>

In sum, the real concern is how China’s system is operating in fact with respect to implementing its TRIMs obligations and in those sectors where China has reserved majority ownership in joint ventures for Chinese nationals. In assessing the factor of joint ventures and other investments, we suggest that appropriate benchmarks should include:

- whether China has removed substantial restrictions on foreign investments on industries where such restrictions do not exist in the United States,
- whether, based on surveys of U.S. producers or other independent public data, China is directly or indirectly forcing technology transfer for companies investing in China, and
- whether China is in compliance, both de facto as well as de jure, with its TRIMs Agreement obligations.

**4. The extent of government ownership or control of the means of production -- 19 U.S.C. § 1677(18)(B)(iv)**

Government ownership or control of the means of production can be highly market-distortive because such entities may not operate on market principles but rather on the basis of political or other non-commercial objectives.

China’s ownership of the means of production is substantial. China’s state-owned enterprises (SOEs) are a “gargantuan force in the economy” and dominate vital industries such as financial services, power, and telecommunications.<sup>27</sup> In 2003, SOEs employed half of China’s

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<sup>26</sup> See USTR, *2004 National Trade Estimate Report on Foreign Trade Barriers* at 87. See also Kathryn Kranhold, *China's Price for Market Entry: Give Us Your Technology, Too*, WALL STREET JOURNAL, Feb. 26, 2004, p. 1.

<sup>27</sup> See *Spurring Performance in China's State-Owned Enterprises*, The McKinsey Quarterly, November 4, 2004, available at Forbes.com ([http://www.forbes.com/business/2004/11/04/cx\\_1104mckinseychina6.htm](http://www.forbes.com/business/2004/11/04/cx_1104mckinseychina6.htm)).

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750 million workers and controlled 57 percent of its industrial assets.<sup>28</sup> Moreover, government ownership or control extends below the central government level to the provinces and local governments. China views SOEs as essential entities in its economic structure:

For China's top leadership .... SOE reform is not about profits, and certainly not about privatisation. The aim is not to reduce the state's control over key sectors of the economy, but to make that control more effective. If a stockmarket listing of the sale of a stake can bring in technology, private-sector expertise and discipline, well and good. But the government intends to remain in control.<sup>29</sup>

In assessing the factor of government ownership or control of the means of production, we suggest that appropriate benchmarks should include:

- whether the level and extent of China's state-owned and state-invested enterprises (including central, provincial and local governments) are on a par with the level of SOEs and SIEs in major market-economy countries other than the U.S. (e.g., OECD countries).<sup>30</sup>

**5. The extent of government control over the allocation of resources and over the price and output decisions of enterprises -- 19 U.S.C. § 1677(18)(B)(v)**

Governmental control over the allocation of resources and over the price and output decisions of enterprises interferes with and distorts the operation of a free market. To the extent the Chinese government exerts control over the allocation of financial resources from the banking sector, whether to reduce inflationary pressures or for other reasons, its interference distorts market-based trade flows.

The Chinese government controls prices on a number of products and services. The USTR's 2004 WTO Compliance Report stated:

In 2004, China continued to maintain price controls on several products and services covering both state-owned enterprises and private enterprises. These price controls may be in the form of either absolute mandated prices or specific pricing policy guidelines as directed by the government and include items such as pharmaceuticals, natural gas, transportation

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<sup>28</sup> *Id.* The Chinese press also has reported that state-owned enterprises (SOEs) account for about 50% of the total industrial output and over two-thirds of the industrial loans. See Article from Zheng Quan Shi Bao, available at [http://www.tianqiang.com.cn/admin/zxk\\_Manage/Html/gzdx/20040205103936.htm](http://www.tianqiang.com.cn/admin/zxk_Manage/Html/gzdx/20040205103936.htm) (Feb. 5, 2004).

<sup>29</sup> *We are the champions*, THE ECONOMIST, March 20, 2004.

<sup>30</sup> Given China's size and potential in the global economy, it is appropriate to consider comparing China's performance on this factor (as well as certain other factors) to that of major market-economy trading nations, such as OECD countries. Reference to such countries provides a readily-available benchmark (which is not tied to the U.S.) for determining whether China's practices conform to market economy standards.

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(including freight transportation), and tobacco and certain other agricultural products.<sup>31</sup>

One of the most effective means by which China can control producers is through the banking system. China's four state-owned banks account for 56% of total bank assets.<sup>32</sup> All banks are subject to control through the China Banking Regulatory Commission and capital adequacy requirements,<sup>33</sup> which exceeds the control of interest rates by central banks in most countries, and gives the government control over almost all enterprises needing loans.

China's banks have been so poorly managed that they depend on government support to survive. Business Week recently reported that although Chinese banks have more than \$3 trillion in savings:

Unfortunately, much of that cash has been allocated so badly by China's four biggest banks and thousands of local lenders that most of them are limping financially -- along with many of the state-controlled enterprises that were recipients of the banks' loans. Beijing to date has spent some \$100 billion bailing out the Big Four -- the Bank of China, China Construction Bank, the Industrial & Commercial Bank of China, and the Agricultural Bank of China. Standard & Poor's estimates the four will need an additional \$190 billion later this decade to stay above water.

Why are China's banks in such terrible trouble? Because for most of their history they weren't banks in the Western sense at all; rather, they were financing arms of the Chinese government.<sup>34</sup>

“Under the government’s guidance, the State-Owned Banks (SOBs) direct their funds to the State-Owned Enterprises (SOEs) and to other enterprises connected to the state via ownership, through ‘policy loans’, at interest rates far below market.”<sup>35</sup> In reality, the “state is providing subsidized financing through its state-owned or directed financial institutions to its

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<sup>31</sup> USTR, *2004 Report to Congress on China's WTO Compliance* (December 2004) at 40.

<sup>32</sup> Bloomberg.com, available at <http://quote.bloomberg.com/apps/news?pid=10000080&sid=a9ej33KkD1Bc&refer=asia>.

<sup>33</sup> China Business Strategy Daily News, April 12, 2004, available at <http://www.china-ready.com/news/April2004/ChinaLiftsCapitalAdequacyRatiosForBanksAgain041204.htm>.

<sup>34</sup> *The Great Bank Overhaul: Can a Chinese bank be a model for heroic reform?*, Business Week Online, August 22, 2005; [http://www.businessweek.com/magazine/content/05\\_34/b3948466.htm](http://www.businessweek.com/magazine/content/05_34/b3948466.htm).

<sup>35</sup> Statement of Solomon Tadesse, Assistant Professor of International Finance, University of South Carolina, *China and the Global Capital Markets*: Hearing Before the U.S.-China Economic and Security Review Commission, August 11, 2005; [http://www.uscc.gov/hearings/2005hearings/written\\_testimonies/05\\_08\\_11wrts/tadesse\\_wrts.pdf](http://www.uscc.gov/hearings/2005hearings/written_testimonies/05_08_11wrts/tadesse_wrts.pdf).

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state-owned companies (in effect, agencies of the government), providing [an] unfair cost advantage.”<sup>36</sup>

Thus, the Chinese Government has been using the banking system to funnel moneys to and away from industries, effectively controlling a critical resource – capital – and affecting output decisions at least on the macroeconomic level.

One example of government control was demonstrated in 2004 when Premier Wen Jiabao indicated that he wanted lending to steel, cement, aluminum, and other industries to slow. As a result, the State Council reduced the percentage of debt companies may use in funding steel, cement, aluminum and real estate projects.<sup>37</sup> Thus, with the power of the purse, the Chinese government is able to select favored or disfavored industries to guide the economy in the direction it wants.

In assessing the factor of government control over the allocation of resources and over the price and output decisions of enterprises, we suggest that appropriate benchmarks should include:

- whether the Chinese banking system is controlled and guided, either de facto or de jure, by the Chinese government;
- whether Chinese banks that hold themselves out as commercial banks and may be publicly traded in global capital markets are, in fact, government-controlled;
- whether Chinese banks and local lenders are operating on market-based commercial principles including making loans based on commercial considerations reflecting the risk of a particular enterprise or transaction; and
- whether the level of bad debts held by Chinese banks is on a par with the level of bad debt in major market-economy countries other than the U.S. (e.g., OECD countries).

**6. Such other factors as the Department of Commerce considers appropriate -- 19 U.S.C. § 1677(18)(B)(vi)**

The sixth statutory factor or criterion that the Department of Commerce must consider in assessing whether to grant a country market-economy status includes all other issues or considerations that the Department deems relevant and appropriate to its determination.

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<sup>36</sup> *Id.*

<sup>37</sup> Bloomberg.com, available at <http://quote.bloomberg.com/apps/news?pid=10000080&sid=a9ej33KkD1Bc&refer=asia>.

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Under this category, with respect to an assessment of China's eligibility for market-economy country status, we suggest that such additional relevant and appropriate factors and benchmarks should include, but not be limited to, the following:

a. Effective enforcement of intellectual property rights

Industries often incur huge expenses to develop new products or create innovative designs or more efficient production processes. When their IP interests are stolen, highly-competitive companies lose sales and see investments undermined, while companies using stolen IP interests gain a false and unfair competitive advantage.

Given the importance of information technology to modern industries, China's failure to effectively enforce intellectual property rights has been highly distortive of U.S.-China trade by causing dramatic losses in export earnings for U.S. companies and reducing costs for Chinese companies. "China's inadequate IPR enforcement is resulting in infringement levels at 90 percent or above for virtually every form of intellectual property."<sup>38</sup> USTR reported that estimates of U.S. losses due to piracy of copyrighted materials alone range between \$2.5 billion and \$3.8 billion annually.<sup>39</sup>

At a recent JCCT meeting in July 2005, China agreed to undertake a number of specific actions aimed at improving IPR enforcement.<sup>40</sup> These new commitments are a welcome development, and it is hoped that such actions will result in real progress in improving IPR enforcement.

Thus, in assessing whether to change China's NME status, we believe that the level of IPR enforcement should be a factor considered by the Department of Commerce. We suggest that appropriate benchmarks should include:

- whether China has made substantial efforts at, and achieved substantial progress in, improving IPR enforcement;
- whether China's IPR enforcement efforts have effectively reduced the level of piracy and counterfeiting of goods to a level that is on par with

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<sup>38</sup> USTR, 2005 Special 301 Review at 16; [http://www.ustr.gov/assets/Document\\_Library/Reports\\_Publications/2005/2005\\_Special\\_301/asset\\_upload\\_file195\\_7636.pdf](http://www.ustr.gov/assets/Document_Library/Reports_Publications/2005/2005_Special_301/asset_upload_file195_7636.pdf).

<sup>39</sup> *Id.*

<sup>40</sup> Specifically, China agreed to increase criminal prosecutions; reduce exports of infringing goods; improve national police coordination; enhance cooperation between law enforcement authorities; expand initiatives to address piracy of movies and audio-visual products; ensure use of legal software in the state-owned sector; fight software end-user piracy; establish a Chinese Embassy IPR ombudsman; rid trade fairs of fake goods; promise to join global internet treaties in 2006; and clarify criminal judicial interpretations (i.e., that criminal thresholds apply to sound recordings and exporters are subject to independent criminal liability). See [http://www.ustr.gov/Document\\_Library/Fact\\_Sheets/2005/The\\_US\\_China\\_Joint\\_Commission\\_on\\_Commerce\\_Trade\\_\(JCCT\)\\_Outcomes\\_on\\_Major\\_US\\_Trade\\_Concerns.html](http://www.ustr.gov/Document_Library/Fact_Sheets/2005/The_US_China_Joint_Commission_on_Commerce_Trade_(JCCT)_Outcomes_on_Major_US_Trade_Concerns.html).

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that in major market-economy countries other than the U.S. (*e.g.*, OECD countries); and

- whether China provides effective IPR enforcement for claims against other forms of IPR losses.

b. [Compliance with WTO subsidy obligations contained in China's protocol of accession and Working Party Report](#)

In its WTO protocol of accession, China committed to eliminate all export subsidies (on both industrial and agricultural goods), as well as a number of domestic subsidies (*e.g.*, subsidies to state-owned enterprises running at a loss).<sup>41</sup> In the 2004 Transitional Review Mechanism, the U.S. identified numerous Chinese programs that appeared to constitute actionable or prohibited subsidies under Articles 1 and 3 of the Agreement on Subsidies and Countervailing Measures (ASCM), or subsidies that China had agreed to eliminate.<sup>42</sup>

China has not submitted any subsidy notifications required under Article 25 of the SCM Agreement since becoming a WTO Member.<sup>43</sup> In their 2005 Subsidies Enforcement Report, the Department of Commerce and USTR noted that “the obligation to notify subsidies is a key element of the Subsidies Agreement, because it provides WTO Members with the ability to evaluate a Member's compliance with the disciplines contained in the Agreement.”<sup>44</sup> At the 2004 TRM, and again at the July 2005 JCCT meeting, China committed to submit a subsidies notification to the WTO by the end of 2005.<sup>45</sup> In any event, China's failure to comply with its subsidy notification obligations so far has made it difficult for trading partners to determine the type and scope of export and other subsidies that China may be providing.

In assessing whether to change China's NME status, we believe that the Department of Commerce should consider:

- whether China has fully complied with its subsidy elimination and notification obligations required by the ASCM or undertaken as part of its WTO accession.

c. [Discrimination against foreign goods and services](#)

To the extent China discriminates against foreign goods and services inconsistent with its WTO obligations, such actions are highly market-distortive. USTR noted in its 2004 WTO

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<sup>41</sup> *Protocol on the Accession of the People's Republic of China*, WT/L/432 (23 November 2001), Section 10 and Annex 5B.

<sup>42</sup> See *G/SCM/Q2/CHN/8* (6 October 2004); *G/SCM/Q2/CHN/9* (6 October 2004).

<sup>43</sup> See USTR & Dept. of Commerce, *Subsidies Enforcement Annual Report to the Congress* (Feb. 2005) at 19.

<sup>44</sup> See *id.*

<sup>45</sup> See USTR, *2004 Report to Congress on China's WTO Compliance* (December 2004) at 39; [http://www.ustr.gov/Document\\_Library/Fact\\_Sheets/2005/The\\_US\\_China\\_Joint\\_Commission\\_on\\_Commerce\\_Trade\\_\(JCCT\)\\_Outcomes\\_on\\_Major\\_US\\_Trade\\_Concerns.html](http://www.ustr.gov/Document_Library/Fact_Sheets/2005/The_US_China_Joint_Commission_on_Commerce_Trade_(JCCT)_Outcomes_on_Major_US_Trade_Concerns.html).

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Compliance Report that “China does not appear to have observed MFN and national treatment requirements in all areas,” citing as examples price controls on medicines and drug reimbursement, preferential border trade policies, and application of the VAT.<sup>46</sup>

In addition, China has not fully observed MFN and national treatment obligations respecting services. For example, China has been slow in fully implementing regulations and procedures for granting distribution rights and opening up direct selling services in accordance with China’s accession agreement.<sup>47</sup>

In assessing whether to change China’s NME status, we believe that the Department of Commerce should consider:

- whether China has eliminated all forms of discrimination against foreign goods and services that are not expressly permitted by the WTO agreements or protocol of accession.

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<sup>46</sup> USTR, *2004 Report to Congress on China’s WTO Compliance* (December 2004) at 35-36.

<sup>47</sup> USTR, *2004 Report to Congress on China’s WTO Compliance* (December 2004) at 5-6.