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Testimony
Before the Committee on Ways and
Means, House of Representatives

For Release on Delivery
Expected at 2:00 p.m., EST
Thursday
October 30, 2003

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Ensuring China's
Compliance Requires a
Sustained and Multifaceted
Approach

Statement of Loren Yager, Director
International Affairs and Trade



Highlights of [GAO-04-172T](#), a testimony before the Committee on Ways and Means, House of Representatives

Why GAO Did This Study

China's accession to the World Trade Organization (WTO) in December 2001 created substantial opportunities for U.S. companies seeking to expand into China's market. In joining the WTO, China agreed to liberalize its trade regime and open its markets to foreign goods and services. However, the U.S. government has become concerned about ensuring that China honors its commitments to offer a more predictable environment for trade.

GAO was asked to describe (1) the monitoring of compliance challenges associated with the scope and complexity of China's WTO commitments and (2) the efforts to date of the key players involved in ensuring China's compliance: the executive branch, Congress, the private sector, the WTO and its other members.

GAO's observations are based on its prior analysis of China's WTO commitments, its previous survey of and interviews with private sector representatives, and its examination of first-year efforts to ensure China's WTO compliance.

www.gao.gov/cgi-bin/getrpt?GAO-04-172T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Loren Yager at (202) 512-4347 or YagerL@gao.gov.

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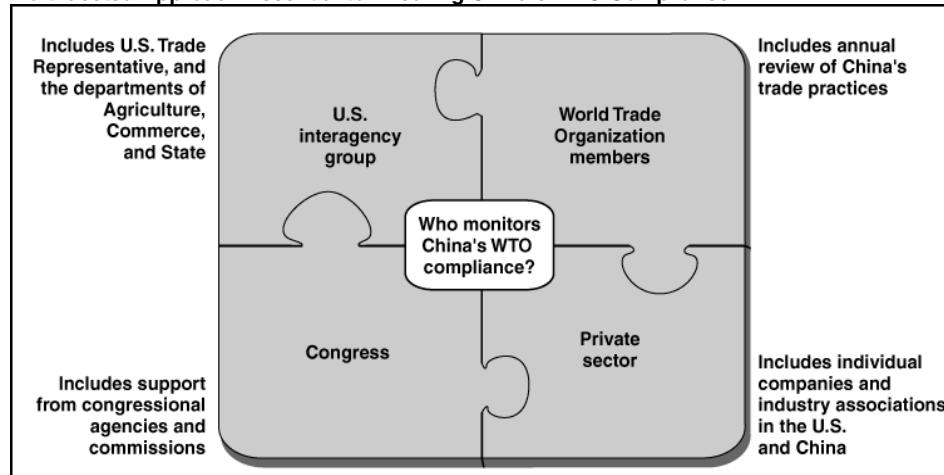
Ensuring China's Compliance Requires a Sustained and Multifaceted Approach

What GAO Found

The scope and complexity of China's WTO commitments present two main challenges to verifying China's compliance with its WTO accession agreement. First, the agreement is very broad: It encompasses more than 800 pages, spans eight broad areas, and sets forth hundreds of individual commitments on how China's trade regime will adhere to the WTO's agreements, principles, and rules and allow greater market access. Second, the agreement is complicated: Interrelated parts will be phased in at different times, and some commitments are so general in nature that it may not be immediately clear whether China has fully complied with its obligations.

Each of the key players involved in ensuring China's compliance—the executive branch, Congress, the private sector, and the WTO and its members—has made efforts to ensure China's compliance. However, the first-year experience in this regard has demonstrated that these efforts will need to be sustained over a long period. The executive branch has applied additional resources and new intra-agency teams to these efforts, but it takes time to organize these activities. Congress has enacted legislation and established new entities to increase oversight of China's compliance. The private sector also has provided information to the executive branch and to Congress on the status of China's compliance efforts. And, within the WTO, a China-specific mechanism was established as a means for WTO members to annually review China's implementation of its commitments. Nonetheless, GAO's analysis indicates that a sustained approach is needed to ensure China's compliance.

Multifaceted Approach Essential to Ensuring China's WTO Compliance



Source: GAO.

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss our observations on the challenges involved in ensuring that China honors its commitments to the World Trade Organization (WTO). This hearing takes place not only at a time of increasing trade between the United States and China, but also at a time of increasing concern about broader aspects of the U.S.-China relationship. Although China's implementation of its WTO commitments cannot fully eliminate those concerns, compliance with its WTO obligations is a central feature of China's economic relationship with the United States and other WTO members. However, as we have found in our analysis of the first year's efforts to monitor and enforce China's compliance with its WTO commitments, the scope and complexity of the agreement indicate that ensuring compliance will be difficult and will require sustained efforts from all the key players to be successful.

To provide you with an update on these issues, today I will discuss (1) the compliance challenges associated with the scope and complexity of China's WTO commitments and (2) the efforts to date of each of the key players involved in ensuring China's compliance with its WTO obligations: the executive branch, Congress, the private sector, and the WTO and its members. My observations are based on a series of studies that we initiated at the request of this Committee and of the Senate Committee on Finance. That work has included a comprehensive analysis of China's commitments,¹ our survey and interviews with the private sector representatives,² and our examination of first-year U.S. compliance efforts.³ Before I turn to the specifics on these issues, let me provide a brief summary.

¹See U.S. General Accounting Office, *World Trade Organization: Analysis of China's Commitments to Other Members*, GAO-03-4 (Washington, D.C.: Oct. 3, 2002).

²See U.S. General Accounting Office, *World Trade Organization: Selected U.S. Company Views About China's Membership*, GAO-02-1056 (Washington, D.C.: Sept. 23, 2002).

³See U.S. General Accounting Office, *World Trade Organization: First-Year U.S. Efforts to Monitor China's Compliance*, GAO-03-461 (Washington, D.C.: Mar. 31, 2003).

Summary

The comprehensive scope and complexity of China's WTO accession agreement present two main challenges for successfully monitoring and enforcing China's compliance with its obligations. First, the broad scope of the agreement, which covers numerous aspects of China's trade regime and market access commitments for goods and services, makes it difficult to determine if each commitment has been fully implemented. Similarly, the complexity of the agreement also presents challenges for assessing compliance. Specifically, some interrelated commitments are phased in at different times, and many commitments are so general in nature that it will be difficult to immediately assess compliance.

A sustained approach from several key players, including the executive branch, Congress, the private sector, and the WTO and its members, is essential to ensuring China's compliance. Since China's accession to the WTO, these actors have undertaken a range of efforts to ensure China's compliance: the executive branch has ramped up its resources for China monitoring and enforcement; Congress has enacted legislation focusing on China's adherence to its obligations; the private sector has continued to monitor China's progress and provide input on compliance priorities; and the WTO and its members have conducted an initial review of China's implementation. These compliance efforts encountered various challenges in the first year, thus demonstrating the need for a sustained approach to successfully ensure that China lives up to its WTO obligations.

Background

China became the 143rd member of the WTO on December 11, 2001, after almost 15 years of negotiations. These negotiations resulted in China's commitments to open and liberalize its economy and offer a more predictable environment for trade and foreign investment in accordance with WTO rules. The United States and other WTO members have stated that China's membership in the WTO provides increased opportunities for foreign companies seeking access to China's market. The United States is one of the largest sources of foreign investment in China, and total merchandise trade between China and the United States exceeded \$145 billion in 2002, according to U.S. trade data. However, the United States still maintains a trade deficit with China: Imports from China totaled \$124.8 billion, while exports totaled \$20.6 billion in 2002. Through the first half of 2003, exports to and imports from China grew about 25 percent compared to same period in the previous year.

The U.S. government's efforts to ensure China's compliance with its WTO commitments are part of an overall U.S. structure to monitor and enforce foreign governments' compliance with existing trade agreements.⁴ At least 17 federal agencies, led by the Office of the U.S. Trade Representative (USTR), are involved in these overall monitoring and enforcement activities. USTR and the departments of Agriculture (USDA), Commerce, and State have relatively broad roles and primary responsibilities with respect to trade agreement monitoring and enforcement. Other agencies, such as the departments of the Treasury and Labor, play more specialized roles. Federal monitoring and enforcement efforts are coordinated through an interagency mechanism comprising several management- and staff-level committees and subcommittees. The congressional structure for funding and overseeing federal monitoring and enforcement activities is similarly complex, because it involves multiple committees of jurisdiction. Congressional agencies, including GAO, and commissions also support Congress's oversight on China-WTO trade issues. In addition to the executive branch and congressional structures, multiple private sector advisory committees exist to provide federal agencies with policy and technical advice on trade matters, including trade agreement monitoring and enforcement.

Scope and Complexity of China's WTO Commitments Present Challenges for Ensuring Compliance

China's accession agreement is the most comprehensive of any WTO member's to date, and, as such, verifying China's WTO compliance is a challenging undertaking for two main reasons. The first reason is the scope of the agreement: The more than 800-page document spans eight broad areas and sets forth hundreds of individual commitments on how China's trade regime will adhere to the organization's agreements, principles, and rules and allow greater market access for foreign goods and services. The second reason is the complexity of the agreement: Interrelated parts of the agreement will be phased in at different times, and some commitments are so general in nature that it will not be immediately clear whether China has fully complied with its obligations in some cases.

⁴For more information on the overall roles and responsibilities of U.S. government agencies in monitoring and enforcing trade agreements, see U.S. General Accounting Office, *International Trade: Strategy Needed to Better Monitor and Enforce Trade Agreements*, GAO/NSIAD-00-76 (Washington, D.C.: Mar. 14, 2000).

Scope of Commitments Poses Inherent Compliance Issues

The comprehensive scope of China's WTO accession agreement represents a challenge for the U.S. government's compliance efforts. The commitments cover eight broad areas of China's trade regime, including import regulations, agriculture, services, and intellectual property rights. Within these eight broad areas, we identified nearly 700 individual commitments that China must implement to comply with its WTO obligations. China has also committed to lower a variety of market access barriers to foreign goods. These obligations include commitments to reduce or eliminate tariffs on more than 7,000 products and eliminate nontariff barriers on about 600 of these products. Additionally, China made commitments to allow greater market access in 9 of 12 general services sectors, including banking, insurance, and telecommunications.

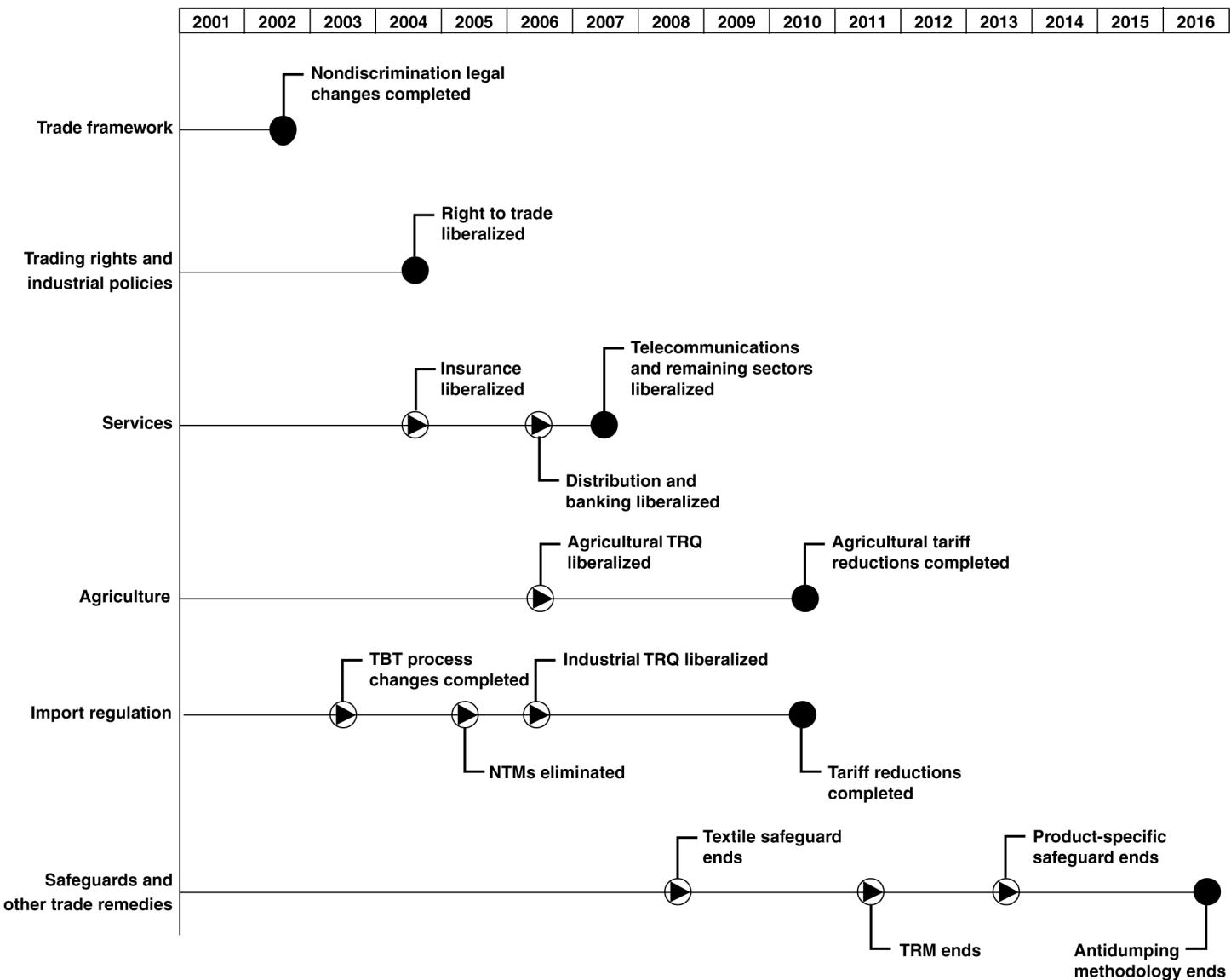
The scope of compliance problems raised in the first year of China's membership reflects the scope of the agreement itself. Although the executive branch's first-year assessment of China's implementation of its WTO commitments acknowledged China's effort and progress in some areas, the assessment also noted compliance problems in all eight broad areas of China's trade regime.⁵ In particular, the executive branch emphasized problems in agriculture, services, and intellectual property rights, as well as a crosscutting concern about transparency. Some preliminary assessments of China's second-year implementation from the private sector suggest that many of those problems persist and that concern about the number and scope of compliance issues continues to increase.

⁵See U.S. Trade Representative, *2002 Report to Congress on China's WTO Compliance* (Washington, D.C.: Office of the U.S. Trade Representative, Dec. 11, 2002).

Complexity of Agreement Presents Additional Challenges for Assessing Compliance

While many of China's commitments were due to be phased in upon China's accession to the WTO in 2001, a number of interrelated commitments are scheduled to be implemented over extended time frames. For example, commitments on trading rights and distribution are not scheduled to be fully phased in until the end of 2004 and 2006, respectively. As a result, foreign businesses will be unable to fully integrate import, export, and distribution systems until that time. Additionally, although market access for most goods and services will be phased in by 2007, some tariffs will not be fully liberalized until 2010. (See fig. 1.)

Figure 1: Summary of Key Phase-in Dates for China's WTO Commitments, 2001-2016



Source: GAO.

Legend

NTM: nontariff measure

TBT: technical barriers to trade

TRQ: tariff-rate quota

TRM: transitional review mechanism

The varying nature of China's commitments also complicates U.S. government compliance efforts. On the one hand, some of China's WTO obligations require specific actions from China, such as reporting particular information to the WTO, or lowering a tariff on a product. Assessing compliance with these specific types of commitments is relatively easy. On the other hand, a significant number of commitments are more general in nature and relate to systemic changes in China's trade regime. For example, some commitments of this type require China to adhere to general WTO principles of nondiscrimination and transparency. Determining compliance with these more general types of commitments is more difficult and can complicate the dialogue over achieving compliance.

It is useful to note that many private sector representatives told us that implementing these general types of commitments, such as those that relate to the rule of law, was relatively more important than carrying out specific commitments to increase market access and liberalize foreign investment in China. Specifically, China's commitments in the areas of transparency of laws, regulations, and practices; intellectual property rights; and consistent application of laws, regulations, and practices emerged as the most important areas of China's accession agreement in our September 2002 survey of and interviews with U.S. companies operating in China.⁶ However, private sector representatives also indicated that they thought these rule-of-law-related commitments would be the most difficult for China to implement.

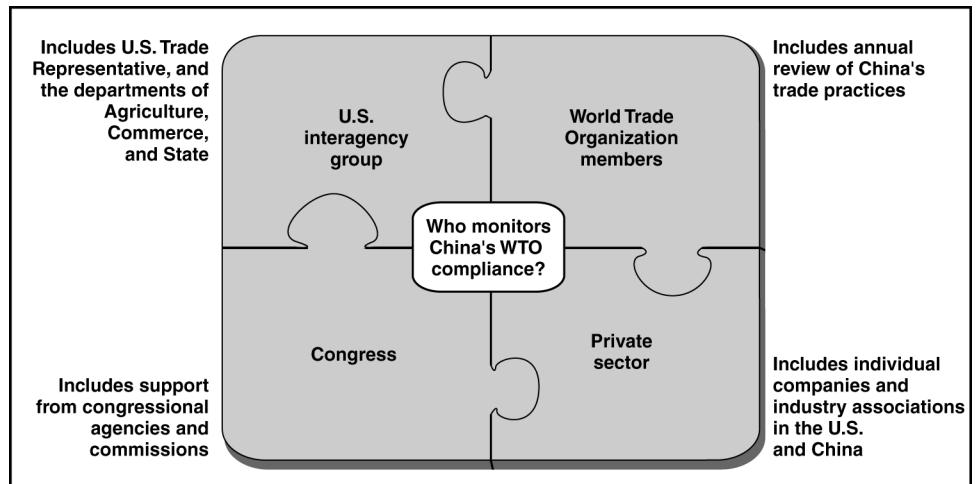
Sustained Effort from Key Players Required to Ensure China's Compliance, but First-year Experience Demonstrates Challenges

Because China is such an important trading partner, ensuring China's compliance with its commitments is essential and requires a sustained effort on the part of the executive branch, Congress, the private sector, and the WTO and its other members. (See fig. 2.) For example, the executive branch has extensive involvement in monitoring and enforcing China's commitments, and additional resources and new structures have been applied to these tasks. However, the U.S.'s first-year experience showed that it takes time to organize these structures to effectively carry out their functions and that progress on the issues can be slow. In addition to the executive branch's efforts, Congress has enacted legislation, provided resources, and established new entities to increase oversight of China's compliance. The private sector also has undertaken a wide range of efforts that provide on-the-ground information on the status of China's

⁶For a further description of our results, see GAO-02-1056.

compliance efforts and input to the executive branch and to Congress on priorities for compliance efforts. Finally, the WTO has existing mechanisms as well as a new, China-specific mechanism created as a means for WTO members to annually review China's implementation of its commitments. Nonetheless, despite the involvement of all of these players in the first year, the United States will need a sustained—and cohesive—approach to successfully carry out this endeavor.

Figure 2: Multifaceted Approach Essential to Ensuring China's WTO Compliance



Source: GAO.

Key Executive Branch Agencies Have Increased Focus on China's Compliance, but First-Year Efforts Demonstrate Challenges

China's accession to the WTO has led to increased monitoring and enforcement responsibilities and challenges for the U.S. government. In response to these increased responsibilities, USTR and the departments of Commerce, Agriculture, and State have undertaken various efforts to enhance their ability to monitor China's compliance with its WTO commitments. Agencies have reorganized or established intra-agency teams to improve coordination of their monitoring and enforcement efforts. Additionally, the agencies have added staff in Washington, D.C., and overseas in China to carry out these efforts. For example, estimated full-time equivalent staff in key units that are involved in China monitoring and enforcement activities across the four agencies increased from about 28 to 53 from fiscal years 2000 to 2002, with the largest increases at the Department of Commerce. On a broader level, USTR has established an interagency group to coordinate U.S. government compliance activities. The interagency group, which utilizes the private sector to support its efforts, was very active in monitoring and responding to issues during the

first year of China's membership. Nevertheless, it took some time for agencies to work out their respective roles and responsibilities in the interagency group.

Monitoring and enforcing compliance with WTO requirements is a complex and challenging task, as shown by our 2002 assessment of the U.S. government's efforts to ensure China's compliance with commitments regarding administration of tariff-rate quotas (TRQ)⁷ for certain bulk agricultural commodities.⁸ TRQ implementation problems in 2002 included concerns about Chinese authorities missing deadlines for issuing TRQs on certain bulk agricultural commodities; disagreement over whether China's interpretation of its commitments met WTO requirements; and questions about whether China's administrative practices were in keeping with its obligations. The United States has undertaken both bilateral and multilateral efforts to settle these complex issues. The large number of U.S. government activities on these issues alone, which still are not fully resolved, included at least monthly engagements with China and illustrates the extensive effort agencies must undertake to identify problems, gather and analyze information, and respond to some issues.

Congressional Focus on China Compliance Issues Has Increased Substantially

Congress has had an active role in overseeing trade relations between the United States and China and in setting expectations for vigilant monitoring and enforcement of China's WTO commitments. In the U.S.-China Relations Act of 2000,⁹ Congress found that for the trade benefits with China to be fully realized, the U.S. government must effectively monitor and enforce its rights under China's WTO agreements. To accomplish this, Congress

- authorized additional resources at USTR and the departments of Commerce and Agriculture;
- called for an annual review of China's compliance in the WTO;

⁷Under China's TRQ commitments, a specific quantity of certain agricultural bulk commodities is to be allowed in at a low duty, while imports above that quota face higher tariffs.

⁸See GAO-03-461.

⁹This constituted a major part of the legislation that led to China's receiving permanent normal trade relations status. See Pub. L. No. 106-286, 114 Stat. 880.

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- established the Congressional-Executive Commission on the People's Republic of China to monitor China's compliance with human rights and the development of the rule of law in China;
 - established a Task Force on the Prohibition of Importation of Products of Forced Prison Labor from China;
 - authorized a program to conduct rule of law training and technical assistance in China; and
 - enacted legislation implementing China's WTO commitment allowing WTO members to apply a product-specific safeguard when increases in Chinese imports threaten or cause injury to domestic industry.

Congress also required that the executive branch issue several China trade-related reports to assist its continuing oversight. These requirements included USTR's annual report on China's compliance, which is based in part on input from the general public. In addition, this Committee, together with the Senate Finance Committee (on a bipartisan basis), requested that we continue our work on China-WTO issues and report on China's compliance, executive branch efforts, and U.S. business views over 4 years. Finally, congressional committees and commissions have held at least 35 China-focused hearings since 2001—a further indication of congressional involvement in U.S.-China issues.

Private Sector Plays Key Role in Monitoring China's Compliance

U.S. businesses operating in China provide valuable assistance in monitoring the status of China's implementation of its WTO commitments, and, as such, effective coordination between the U.S. government and the private sector is essential. For example, industry-specific expertise and input from within the private sector are indispensable components for determining whether the scores of highly technical laws and regulations that the Chinese government issues are WTO compliant and being implemented. Further, private sector industry and business associations are active in conducting their own analyses and issuing reports on China's WTO compliance, providing input to congressional committees and commissions, engaging the Chinese on specific WTO issues, and representing their members' interests to the U.S. government in order to inform the U.S.'s compliance priorities.

WTO Has General and China-specific Mechanisms to Ensure Compliance

The WTO's framework of more than 20 multilateral agreements covers various aspects of international trade and sets forth the rules by which China and other members must abide. Notably, the WTO's dispute settlement mechanism is intended to give all WTO members access to a formal mechanism for pursuing and resolving WTO-related compliance issues with other members, including China. Thus far, no WTO member has initiated a dispute settlement case against China, although some Members of Congress and private sector groups have urged the U.S. government to initiate a case related to China's administration of TRQs.

Another WTO mechanism relates specifically to China. China's accession commitments created a Transitional Review Mechanism (TRM), as a means for WTO members to annually review China's implementation of its commitments for 8 years, with a final review in the 10th year following China's accession.¹⁰ Just as establishing the TRM was one of the more challenging issues to negotiate with China, implementing the TRM process during the first year (2002) also proved challenging. Disagreement among WTO members, including China, over the form, timing, and thoroughness of the TRM led to a limited initial review of China's trade practices. The review did not meet U.S. expectations and illustrated the challenges of gaining consensus with China and other members within this multilateral forum over implementation issues. Although U.S. officials cited benefits from participating in the initial review, they expressed disappointment over the first-year results. U.S. officials are hopeful that future reviews will be more comprehensive. The second-year TRM is under way, but it is still too early to determine if the current review will meet U.S. and other WTO members' expectations.

Concluding Observations

In assessing China's first-year implementation efforts, the executive branch, other WTO member government officials, and many private sector representatives observed that, despite several first-year compliance problems, China had demonstrated a willingness to implement its WTO commitments. For example, the executive branch noted China's progress in revising the framework of laws and regulations governing various aspects of China's trade regime. In the second year of China's membership, however, concerns about the number of compliance

¹⁰The TRM is additional to WTO's trade policy review mechanism, which provides for a broad review of the trade regimes of all WTO members on a scheduled basis. However, WTO members viewed the trade policy review mechanism as insufficient to oversee China's implementation of its commitments and pursued the TRM.

problems have grown, as well as the number of events that have potentially interfered with China's implementation of its commitments. Specifically, some observers have noted events such as changes in China's central government leadership, reconfigurations of key ministries, a growing concern about unemployment and labor unrest, and the SARS outbreak as possibly temporarily interrupting progress on implementation.

In closing, Mr. Chairman, the theme of my testimony is that a cohesive and sustained approach is necessary to monitor and enforce China's commitments to the WTO. I believe that this hearing that focuses on the key elements of the U.S.-China economic relationship and brings together three of the key players is exactly the kind of oversight that is necessary to ensure that a cohesive and sustained approach is actually carried out.

Mr. Chairman and Members of the Committee, this concludes my prepared statement. I would be happy to answer any questions on my testimony that you may have.

Contacts and Acknowledgments

For further information regarding this testimony, please contact Adam Cowles at (202) 512-9637. Matthew Helm, Rona Mendelsohn, Richard Seldin, and Kim Siegal also made key contributions to this testimony.

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