

**GAO**

Report to the Committee on Finance,  
U.S. Senate, and the Committee on Ways  
and Means, House of Representatives

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April 1995

# U.S.-CHINA TRADE

## Implementation of the 1992 Prison Labor Memorandum of Understanding



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United States  
General Accounting Office  
Washington, D.C. 20548

General Government Division

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The Honorable Bob Packwood  
Chairman  
The Honorable Daniel P. Moynihan  
Ranking Minority Member  
Committee on Finance  
United States Senate

The Honorable Bill Archer  
Chairman  
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House of Representatives

The People's Republic of China has one of the world's fastest growing economies and has rapidly become one of the U.S.' most important trading partners. In 1993, U.S. imports from China totaled \$31.5 billion, and U.S. exports reached \$8.8 billion. Since 1992, the United States and China have entered into several trade agreements to help resolve bilateral trade issues, such as U.S. market access in China and the U.S. prohibition on importing goods made with Chinese prison labor.<sup>1</sup> In May 1993, President Clinton signed executive order 12850. The executive order added a requirement for the administration to review China's compliance with the August 7, 1992, U.S.-China prison labor memorandum of understanding (MOU)<sup>2</sup> as part of the President's annual assessment of China's most-favored-nation (MFN) status in 1994.<sup>3</sup> (See app. I for details about China's commitments under the MOU.)

Because of ongoing congressional interest in U.S. trade with China, we self-initiated a review of recent issues regarding the U.S.-China MOU on prison labor. Specifically, our objectives were to describe (1) the U.S. Customs Service's assessment of China's compliance with the prison labor MOU and (2) the experience of the U.S. government in obtaining information sufficient to enforce the prohibition against goods made with Chinese prison labor since the MOU was signed. (See app. II for detailed

<sup>1</sup>With certain exceptions, the importation of products made with prison labor is prohibited by section 307 of the Smoot-Hawley Tariff Act of 1930, as amended (19 U.S.C. 1307 (1988)).

<sup>2</sup>According to officials at the Department of State, an MOU is considered by the United States to be a binding international agreement.

<sup>3</sup>MFN is a commitment that a country will extend to another country the lowest tariff rates it applies to any third country.

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information about U.S. laws and regulations prohibiting prison labor imports.)

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## Results in Brief

Although in 1993 Customs was concerned that the Chinese government had not sufficiently demonstrated a willingness to fulfill its responsibilities under the prison labor MOU in a timely and thorough manner, Customs told us that Chinese officials had shown more recent signs of cooperation. For example, in March 1994 China signed an implementation agreement that for the first time specified time frames and procedures for mutual compliance with the MOU. Nevertheless, while this agreement may support Customs' ability to obtain more timely responses to U.S. requests to visit prisons suspected of producing goods exported to the United States, Customs officials cited significant differences in China's prison system from those found in the United States, which may inhibit China's ability to comply with the MOU (e.g., incomplete or missing Chinese government records).

Customs officials said they had experienced recent successes in obtaining information from Chinese officials under the MOU sufficient to make administrative determinations that prison labor may have been involved in imported goods. However, officials at the Department of Justice told us they were concerned whether the MOU or any other agreement could provide Justice attorneys with the information necessary to defend Customs' decisions in an efficient and inexpensive manner because of the evidence that might be required in section 307 cases. Justice attorneys must produce such information before the U.S. Court of International Trade (CIT) to defend Customs' determinations to exclude products from entering the United States because they were found to be made with prison labor;<sup>4</sup> such Customs determinations are referred to as "findings." In December 1994, in its first case ever regarding a Customs determination that U.S. imports of Chinese goods were made with prison labor, CIT upheld an affirmative Customs finding (i.e., a finding that imported goods from China had been made with prison labor).<sup>5</sup> (See app. III for more information about this CIT case.) CIT based its decision to uphold the

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<sup>4</sup>CIT, located in New York City, is composed of nine judges. The power of the court is exercised by a single judge, although under certain circumstances the Chief Judge may convene a panel. The court has jurisdiction over a broad range of civil actions involving international trade, including jurisdiction over section 307 cases. Final decisions of CIT can be appealed before the Court of Appeals for the Federal Circuit.

<sup>5</sup>China Diesel Imports, Inc. v. The United States, No. 94-185, slip op. at 13 (CIT, Dec. 7, 1994). This case involved imports of Chinese diesel engines allegedly made with prison labor. The original Customs determination in this case predated the MOU.

government on several factors involving evidence obtained from Chinese government documents. Justice officials believe these factors may not be present in future cases primarily because the information used as evidence is no longer published in China. Justice officials, therefore, still have concerns regarding the Department's ability to sustain Customs' findings in future cases that may arise under section 307.

## Background

Following the Chinese government's June 1989 crackdown on protesters in Tiananmen Square, President Bush and Congress began a debate about linking renewal of China's MFN status to improving human rights conditions in China. Among the trade-related issues raised in this debate was the U.S. government's concern about China's exporting goods made with prison labor to the United States. Although Customs officials have no authoritative estimate of such exports from China to the United States, they told us that the amount appears to be small.<sup>6</sup> The Bush administration determined that, in many cases of suspected violations, U.S. officials would need cooperation from law enforcement officials in China to gather sufficient evidence concerning Chinese prison facilities to enforce the section 307 prohibition.<sup>7</sup> As a result, the United States began negotiations with China in 1991 to reach an agreement to improve U.S. access to information needed to enforce section 307. In early August 1992, the United States and China signed the prison labor MOU providing for the exchange of information between both countries regarding their respective prison facilities. Specific terms for implementing the MOU were negotiated in a separate statement of cooperation signed on March 13, 1994.

The MOU provides for the United States and China to exchange information about prison facilities for the enforcement of their own laws. Not only does section 307 in U.S. law prohibit importing prison labor products, but the Chinese government prohibits exporting them as well. In general, the provisions of the MOU allow either country to request (1) respondent country investigations of facilities suspected by the requesting country to

<sup>6</sup>According to Customs, as of October 19, 1994, five cases had proceeded through the administrative process to final determination regarding illegal Chinese exports to the United States since 1990. Customs makes such determinations when probable cause exists that certain imported goods are subject to provisions of section 307 and are therefore prohibited from importation; these determinations must be approved by the Secretary of the Treasury. Two of the five final determinations remain in force, and two have been withdrawn. The fifth one resulted in a criminal conviction.

<sup>7</sup>For further information on China's prison system, see Foreign Affairs: Forced Labor in the People's Republic of China (GAO/NSIAD-90-244BR, July 23, 1990).

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be exporting goods made with prison labor,<sup>8</sup> and (2) visits arranged by the respondent country to allow officials of the requesting country to visit suspected facilities to gather evidence to resolve allegations of trade in prison produced goods. Other provisions of the MOU allow either country to request available information and evidence from the respondent country in a form admissible in judicial or administrative proceedings of the requesting country.

The U.S. Customs Service and the Department of Justice are the primary agencies tasked with enforcing U.S. laws against importing goods made with prison labor. Customs investigates violations of prison labor laws and makes administrative determinations to exclude products from the United States that it determines are in violation of section 307. The Justice Department defends all Customs determinations challenged in U.S. courts, and prosecutes criminal cases brought under section 1761(a) of title 18, U.S. Code.<sup>9</sup> For example, Justice officials concluded their first case defending an affirmative Customs determination involving U.S. imports of Chinese products before CIT on December 7, 1994; however, Customs' determination of this case predated the MOU.

In addition to Customs and the Justice Department, the State Department plays an important negotiating and diplomatic role. Customs and the State Department cooperated to negotiate the prison labor MOU and, at certain times, the State Department worked with Customs in monitoring progress on the MOU. In 1993, Customs made investigating illegal importation of forced labor goods a priority under its 1993 national trade enforcement strategy and sent one full-time staff member to Beijing primarily to focus on prison labor issues.

On May 26, 1994, President Clinton decided to renew the granting of MFN status to China for another year. His decision was based on the State Department's positive assessment of China's emigration policies pursuant to the requirements of the Jackson-Vanik amendment to the Trade Act of

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<sup>8</sup>In this report, a "respondent" country refers to the country answering a request to exercise options laid out in the MOU. A "requesting" country refers to the country that is seeking to use one of the MOU's options.

<sup>9</sup>On April 23, 1992, the E. W. Bliss Company of Hastings, MI, pleaded guilty to violating two counts of the criminal code for importing Chinese stamping machines made with prison labor. The E. W. Bliss Company was fined \$75,000 and ordered to reexport the 31 stamping machines that had been seized by Customs. This case predated the MOU and is the only criminal case that Justice officials were aware of, in which an importer of Chinese goods made with prison labor was convicted and fined.

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1974 (P.L. 93-618, 1975).<sup>10</sup> In addition, on reviewing progress under the prison labor MOU, the President determined that China was in compliance with the MOU's provisions. Furthermore, following the criteria established in his May 1993 executive order 12850, the President reviewed China's overall progress with various nonmandatory human rights conditions listed in that executive order. The President also said that compliance with the Jackson-Vanik legislative requirement would be the only condition specified for renewing China's MFN status during his administration.

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## Scope and Methodology

To develop information on Customs' assessment of China's compliance with the prison labor MOU, we interviewed officials from Customs as well as the State Department. We also reviewed reports and cables prepared by both Customs and the State Department that discussed prison labor issues regarding China; these documents generally corroborated the information we received from U.S. officials. To identify the experiences of Customs and the Justice Department regarding the enforcement of section 307, we met with headquarters and regional officials at the U.S. Customs Service and at the Department of Justice in Washington, D.C., and New York City. We also spoke with Customs officials at the U.S. embassy in Beijing, China, and the U.S. mission in Hong Kong. In addition, we discussed the issues raised by Customs and the Justice Department with officials at the State Department to obtain their views. We obtained the background and history of the prison labor MOU from documents prepared by the Library of Congress, Congressional Research Service, and the State Department.

In December 1994, we obtained oral comments on a draft of this report from various officials at the U.S. Customs Service and the Departments of Justice and State. Their comments are presented on pages 11 to 12. We did our work between November 1993 and December 1994 in accordance with generally accepted government auditing standards.

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<sup>10</sup>The Jackson-Vanik amendment prohibits extending, or sets conditions upon the President's ability to extend, MFN status to nonmarket (or centrally planned) economies. The amendment allows such countries to receive MFN status only if the President determines that the country permits free and unrestricted emigration.

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## Assessing China's Compliance With the 1992 Prison Labor MOU

In testimony in the fall of 1993, Customs officials reported reaching an impasse concerning China's compliance with the letter and spirit of the August 1992 prison labor MOU.<sup>11</sup> The issue centered on the lack of timely and thorough responses from the Chinese government to U.S. requests for information and visits under the MOU.

First, according to Customs' testimony, the Chinese government had not provided timely responses to U.S. requests that China officially investigate suspected prison facilities and that China make arrangements for U.S. officials to visit those facilities. Customs reported that, as of September 1993, Chinese officials had responded in 16 of the 31 cases that the U.S. government requested investigation and had granted 1 of the 5 visitation requests made at that time.<sup>12</sup> Customs told us that by December 1993, Chinese officials had finally concluded investigation of all 31 alleged prison labor cases requested by the United States. However, Customs officials remained concerned that the amount of time spent for each Chinese investigation varied from case to case, and that they could not depend on a timely response.

Second, Customs' testimony also indicated that Chinese investigations did not provide the evidence necessary for Customs to resolve prison labor cases and that therefore U.S. visits to suspected prison facilities were required. Customs told us that much of the information provided by the 31 investigations that Chinese officials had concluded as of December 1993 was insufficient for Customs to resolve its cases. Consequently, Customs required additional information obtained through U.S. visitations in order to complete its work. However, Customs officials also encountered delays when requesting that the Chinese government arrange visits to Chinese facilities. According to Customs, as of December 1994, four of the original five visitation cases requested in 1992 were still pending.

While Chinese officials eventually responded to the initial 31 investigations, the U.S. government remained concerned about the implementation of the MOU. During a visit by the Secretary of State in March 1994, both countries signed another agreement, known as the "Statement of Cooperation on the Implementation of the Memorandum of Understanding Between the United States and China on Prohibiting Import

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<sup>11</sup>Testimony of George J. Weise, Commissioner, U.S. Customs Service, Before the House Foreign Affairs Subcommittee on International Economic Policy and Trade, September 9, 1993 (102nd Congress, 2nd session).

<sup>12</sup>The U.S. government may request official visits to Chinese facilities when it believes that initial Chinese investigations did not provide the information and evidence necessary to resolve specific cases.

and Export Trade in Prison Labor Products.” This agreement specified time frames and procedures for investigating and visiting facilities in which goods were allegedly made with prison labor. The agreement did not specify terms for addressing the thoroughness of Chinese investigations cited by Customs officials. During the Secretary of State’s trip to China, the United States presented another 20 requests for investigation.

Customs officials stated that significant differences in China’s prison system from those found in the United States may limit China’s ability to comply with the MOU. One primary factor affecting Customs’ assessment of the Chinese government’s compliance with the MOU is the current status of business and personnel records that are kept in China, including those in prison or detention facilities. The MOU states that

“Upon request, each Party will furnish to the other Party available evidence and information regarding suspected violations of relevant laws and regulations in a form admissible in judicial or administrative proceedings of the other Party.” (Emphasis added.)

However, Customs and State officials agreed that the standards for record keeping in Chinese prisons were not based on the same standards as those used in the United States. Customs officials reported that Chinese prison records they reviewed were often incomplete or missing altogether. Customs officials maintained that the Chinese government was still developing its ability to meet U.S. government information needs and to produce records of prison labor investigations in a more thorough manner. In addition, Customs officials stated that their ability to retrieve such documents was limited by China’s lack of data processing methods and equipment commonly used to maintain these records in the United States.

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## Benefits, Problems, and Limitations Regarding U.S. Enforcement of Prison Labor Laws

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### MOU Useful but Not Fully Tested

According to Customs officials, the prison labor MOU has assisted Customs in obtaining information sufficient to make determinations under section

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307 of the Smoot-Hawley Tariff Act of 1930, as amended. Customs officials told us that the MOU had been helpful in facilitating the gathering of information from China and had improved Customs' ability to bring some cases to closure. For example, since December 1993 Customs officials utilized information obtained through official visitations under the MOU to make determinations on two cases regarding imports of socks produced and of grapes harvested allegedly using Chinese prison labor. However, Customs officials concluded that there was no evidence of prison labor exports of these products to the United States and that there was thus no reason for Customs to exclude these items. Thus, according to Customs officials, it is too soon to tell whether the MOU will be useful to Customs in its efforts to collect incriminating evidence. Customs officials said it is untested whether the Chinese government will be as cooperative in providing evidence where exported goods have actually been manufactured with prison labor.

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## Justice's Concerns

Justice officials are concerned whether the MOU or any other agreement could provide Justice attorneys with the information they need in an efficient and inexpensive manner, if the Justice Department has to defend affirmative Customs' findings before CIT. The principal reason for the Justice Department's concern is that much of the information collected by Customs under the MOU, such as interviews with Chinese prisoners, may not be admissible at trial under U.S. law. Justice officials are concerned about the extent to which the U.S. government may have the burden of producing evidence that might be required to sustain Customs' findings in future section 307 cases.

According to Justice officials, in litigating section 307 cases the Department sought application of the standard prescribed for informal adjudicatory proceedings under the Administrative Procedures Act (APA).<sup>13</sup> Under APA, judicial review of agency adjudicatory decisions would usually be limited to the record compiled by the agency. For example, the review would essentially concern whether a reasonable basis existed for the Customs officer's determination at the time the finding was made. Therefore, CIT would not decide whether the agency's finding was factually correct, and the importer would not be allowed to introduce new evidence that had not been part of the record before Customs' determination. Most importantly, any evidence that was properly considered by Customs in reaching its determination would be admissible as part of the record in such a proceeding. Consequently, information gathered under the MOU,

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<sup>13</sup>5 U.S.C. 706, 1988.

such as the testimony of U.S. officials who interviewed Chinese inmates, could be cited as part of the record in support of a Customs finding.

If CIT did not apply the APA standard of review in section 307 cases, the alternative would be to conduct a de novo review. In a de novo review, CIT makes its own findings concerning whether the goods in question were prison labor exports; that is, CIT adjudicates all factual issues and the importer is able to introduce new evidence. The problem for the Justice Department in defending a Customs determination to exclude imports under section 307 is that in a trial de novo, the rules of evidence in some instances might not allow admission of certain evidence developed by Customs in making its determination. For example, the testimony of U.S. government witnesses who interviewed Chinese prison inmates might at times be precluded by the rule against hearsay.

Justice officials agreed that the scope of the present MOU was broad enough to cover the various kinds of evidence that might be required in a de novo proceeding. Such evidence might include commercial and personnel records of the factory in question; the live testimony of the prison official responsible for keeping such records; and, in some instances, a sample of the factory's product submitted for material analysis.

Nevertheless, Justice officials remained concerned about whether they would be able to successfully defend Customs' findings in a de novo proceeding for several reasons. For example:

- The Chinese government's willingness to adhere to the MOU when the United States seeks evidence—such as commercial or personnel records or a sample of a factory's product—is still untested.
- According to Justice officials, even if the Chinese government furnished all available evidence, the evidence required in a de novo proceeding under section 307 may often not exist. As noted earlier, the current system of maintaining business and personnel records in Chinese prisons is not based on the same standards as those used in the United States, according to Customs.
- Even where commercial and personnel records are maintained by prison factories in China, other aspects of the Chinese penal system may limit U.S. officials' ability to obtain information specific enough to defend a Customs determination under section 307. For example, just the fact that a prison has a factory does not necessarily mean that all goods

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manufactured are those produced by prisoners.<sup>14</sup> Justice officials stated that this may pose a problem if it becomes necessary to establish that at least one factory worker—who was a prisoner on a particular date—worked on a specific product that was exported to the United States.

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### CIT Made Its First Determination on Imported Goods Made With Chinese Prison Labor

On December 7, 1994, in *China Diesel Imports, Inc. v. the United States*, CIT issued its first determination regarding imported goods that Customs had earlier determined were made with Chinese prison labor.<sup>15</sup> In November 1991, Customs excluded diesel engines manufactured in China under section 307 as goods made by convict or forced labor. The importer, China Diesel, Inc., filed suit before CIT seeking entry of the merchandise. In its preliminary opinion, issued in June 1994, CIT refused to apply the APA standard of review and held that it must adjudicate all factual issues in a trial *de novo*.<sup>16</sup> However, in its December 7, 1994, judgment, CIT held that the importer had the burden of proving that its diesel engines were not made, in whole or in part, with convict labor. Because CIT concluded that China Diesel, Inc., had not met this requirement, it upheld Custom's determination that the engines in question were convict made and found that Customs had properly excluded them from entry into the United States.

Despite the outcome of *China Diesel*, Justice officials still have concerns regarding their ability to gather evidence efficiently and inexpensively in section 307 cases under a *de novo* standard of review. Justice officials told us that the outcome of *China Diesel* may have depended on certain circumstances that may not be present in future cases. For example, in reaching its decision regarding the *China Diesel* case, CIT said that it had relied heavily upon various Chinese government and reference publications, which appeared to identify as a penal institution the facility in which the engines were manufactured. According to the CIT's decision, these documents alone would have sufficed to sustain Customs' determination. Justice officials said that this evidence is not likely to be available in future cases because the Chinese government has ceased identifying such penal facilities in its publications as of 1990.

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<sup>14</sup>Evidentiary problems arise because in China, many former prisoners continue their employment in prison factories after their sentences have been completed. In addition, family members of prisoners are often employed in the same factories.

<sup>15</sup>No. 94-185, slip. op. (CIT, Dec. 7, 1994). The original Customs determination in this case predated the MOU.

<sup>16</sup>No. 94-90, slip. op. (CIT, June 2, 1994).

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According to Justice officials, the problems in gathering evidence in China do not reflect any inadequacy in the scope of the MOU that was negotiated with the Chinese government. Rather, such difficulties reflect the differences in commercial practices and court standards between the two countries. Justice officials stated that these problems are typical of the obstacles faced by the U.S. government or private companies seeking evidence in some developing countries for the purposes of litigating related issues in the United States.

Justice officials therefore question whether the current MOU, or any other agreement negotiated with China, would be able to provide the evidence that might be required under a de novo review of section 307 cases. According to the Justice Department, Congress could address the problem by modifying section 307 to require that a judicial review be conducted under APA standards for informal adjudicatory proceedings. However, it would be very difficult to modify the MOU to accommodate the needs of a de novo review.

While Customs determinations and CIT reviews under section 307 are civil proceedings, title 18 provides criminal penalties for the knowing importation or transportation in interstate commerce of convict or prison-made goods.<sup>17</sup> If a case is brought before a criminal court, the standard of evidence required would be even greater than that in a de novo review in a civil proceeding. In U.S. criminal proceedings, Justice prosecutors would have to prove beyond a reasonable doubt that the importer knowingly transported the goods in question.

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## Agency Comments

We obtained oral comments on a draft of this report from officials at the U.S. Customs Service and the Departments of Justice and State. At the Customs Service, on December 1, 1994, the Director for Fraud Investigations and the Director of the Far East Desk, both in the Office of Enforcement; the Associate Chief Counsel for Enforcement in the Office of the Chief Counsel (regarding legal issues); and an Import Specialist in the Office of Trade Operations concurred with the information as presented. In general, Customs officials stated that this report was a well balanced and fair presentation of the prison labor MOU and of Customs' views on the MOU. They provided other minor suggestions that we incorporated where appropriate.

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<sup>17</sup>Title 18 U.S.C. 1761(a).

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On December 1, 1994, we discussed a draft of this report with a Senior Attorney of the General Litigation and Legal Advice Office in the Criminal Division at the Department of Justice. The draft was also reviewed by the Acting Chief of General Litigation and Legal Advice, Criminal Division. On December 8, 1994, we discussed a draft of this report with the Director of Commercial Litigation, Civil Division, at the Department of Justice. These Justice officials said that no agreement would ensure U.S. officials the ability to obtain information from China sufficient to withstand de novo judicial review in U.S. courts. We strengthened this point in the report. Overall, they agreed with the information in the report as presented and provided other minor suggestions that we incorporated where appropriate.

On December 8, 1994, we discussed a draft of this report with the Deputy Director of the Office of Chinese and Mongolian Affairs and a Senior Attorney in the Office of the Legal Adviser at the State Department. They viewed the MOU as adequate to assist the U.S. government in obtaining information from China and said that it was too early to determine the outcome of any U.S. judicial review. While the MOU has not been fully tested thus far, we believe the views of the Justice Department presented here provide useful insight in anticipating future enforcement concerns regarding China. State officials also suggested other minor changes, which we included in this report where appropriate.

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We are sending copies of this report to the U.S. Trade Representative; the Secretaries of State, the Treasury, Commerce, and Justice; and the Commissioner of the U.S. Customs Service. We will make copies available to others upon request.

The major contributors to this report are listed in appendix IV. If you have any questions about this report, please call me on (202) 512-4812.



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## Abbreviations

APA	Administrative Procedures Act
CIT	Court of International Trade
MFN	most favored nation
MOU	memorandum of understanding

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# China's Commitment Under the 1992 Prison Labor MOU

On August 7, 1992, the United States and China concluded the prison labor MOU establishing four mutual commitments for exchanging information about respective U.S. and Chinese prison facilities.<sup>1</sup> Throughout these negotiations, the Chinese government was highly concerned that access to Chinese facilities would appear to violate China's sovereignty over its domestic affairs. Therefore, according to State Department documents, specific terms were included in the MOU to address this concern. In particular, it is the mutual nature of the MOU that allows officials of both countries the opportunity to obtain the information needed from the other country to satisfy domestic enforcement needs.

The MOU lists four broad provisions applicable to both countries. The terms of the MOU allow both countries to request

- investigations of facilities suspected by the requesting country to be exporting goods made with prison labor,
- information on law enforcement and whether these facilities are in compliance with the respondent country's regulations,
- evidence regarding suspected violations of the respondent country's laws and regulations in a form admissible in the requesting country's judicial or administrative proceedings, and
- visits arranged by the respondent country to allow officials of the requesting country to view suspected facilities.

After the MOU was signed, government officials in China and the United States became concerned about the terms for satisfactory implementation of the agreement. Customs officials told us that the lack of time frames and procedures for carrying out the prison labor MOU rendered the agreement difficult to administer. In addition, Chinese government officials were concerned, once information had been exchanged, that the United States was not promptly resolving pending cases. In late 1993, the Chinese government placed a hold on any further requests for visits and information until the United States had resolved those cases already opened. The United States and China continued to negotiate the specific terms for implementation 18 months after the MOU had been signed.

<sup>1</sup>To obtain assistance from other countries on customs-related matters, the United States may enter into a Customs mutual assistance agreement. According to Customs officials, such agreements provide a basis for cooperation and investigation in the areas of commercial fraud, narcotics trafficking, and export control. The assistance is provided for use in all proceedings, whether judicial, administrative, or investigative. However, according to State Department documents, during early negotiations in November 1991, representatives of the United States and China were unable to agree on such an arrangement as a framework for cooperation. According to Customs and State officials, no other country has signed an agreement similar to China's 1992 prison labor MOU with the United States. As of December 1994, Customs officials were working with Chinese officials to negotiate a Customs mutual assistance agreement.

On March 13, 1994, the United States and China signed a "Statement of Cooperation on the Implementation of the Memorandum of Understanding Between the United States and China on Prohibiting Import and Export Trade in Prison Labor Products." The statement of cooperation was intended to aid the timely investigation and visitation of prison labor facilities where goods were allegedly made with prison labor. The statement of cooperation acknowledged both countries' laws and regulations regarding importing and exporting products made with prison labor. It also recognized the good intentions and efforts already made by both countries in implementing the prison labor MOU.

The statement of cooperation then specified the following procedures to be followed under the MOU:

- "First, when one side provides the other side a request, based on specific information, to conduct investigations of suspected exports of prison labor products destined for the United States, the receiving side will provide the requesting side a comprehensive investigative report within 60 days of the receipt of the written request. At the same time, the requesting side will provide a concluding evaluation of the receiving side's investigative report within 60 days of receipt of the report.
- "Second, if the United States Government, in order to resolve specific outstanding cases, requests a visit to a suspected facility, the Chinese Government will, in conformity with Chinese laws and regulations and in accordance with the MOU, arrange for responsible United States diplomatic mission officials to visit the suspected facility within 60 days of receipt of a written request.
- "Third, the United States Government will submit a report indicating the results of the visit to the Chinese Government within 60 days of a visit by diplomatic officials to a suspected facility.
- "Fourth, in cases where the U.S. government presents new or previously unknown information on suspected exports of prison labor products destined for the United States regarding a suspected facility that was already visited, the Chinese Government will organize new investigations and notify the U.S. side. If necessary, it can also be arranged for the U.S. side to again visit that suspected facility.
- "Fifth, when the Chinese Government organizes the investigation of a suspected facility and the U.S. side is allowed to visit the suspected facility, the U.S. side will provide related information conducive to the investigation. In order to accomplish the purpose of the visit, the Chinese side will, in accordance with its laws and regulations, provide an opportunity to consult relevant records and materials on-site and arrange

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**Appendix I  
China's Commitment Under the 1992 Prison  
Labor MOU**

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visits to necessary areas of the facility. The U.S. side agrees to protect proprietary information of customers of the facility consistent with the relevant terms of the Prison Labor MOU.

- "Sixth, both sides agree that arrangements for U.S. officials to visit suspected facilities, in principle, will proceed after the visit to a previous suspected facility is completely ended and a report indicating the results of the visit is submitted."

# U.S. Laws and Regulations Prohibiting Imports Made With Prison Labor

Since 1890, the United States has banned importing goods made by convict labor. The current prison labor statute, section 307 of the Smoot-Hawley Tariff Act of 1930, as amended (19 U.S.C. 1307 (1988)) was preceded by section 51 of the Tariff Act of 1890, which was intended to protect domestic labor from manufactured goods produced by foreign convict labor.<sup>1</sup> During consideration of section 307, a Senate amendment was offered to extend the provision to include goods produced by "forced labor or/and indentured labor." Since some Members of Congress were concerned that the humanitarian aspects of the proposed amendment might harm the U.S. consumer, the Conference Committee on the 1930 Tariff Act added a caveat, the "consumptive demand" clause. This caveat specified that the statute would not apply to goods produced by "forced labor or/and indentured labor" that were not produced "in such quantities in the United States as to meet the consumptive demands of the United States." CIT described section 307 as follows:

"Congress intended to protect domestic workers and producers from unfair competition. But this concern as well as any desire to improve foreign labor conditions were clearly subordinate in section 307, as enacted, to concern for the American consumer's access to merchandise not produced domestically in quantities sufficient to satisfy consumer demand."<sup>2</sup>

Thus, section 307 is intended primarily to protect U.S. producers', consumers', and workers' rights, rather than to promote human rights in other countries.

Under section 307, the Secretary of the Treasury is charged with developing regulations to enforce this provision of the law. The Secretary of the Treasury has delegated to the U.S. Customs Service the responsibility for administering the prohibition on importing goods made by convict or forced labor. To enforce a ban on imports, Customs must gather evidence and determine whether the goods were produced by forced or convict labor. However, such a determination cannot be established by a simple examination of the goods themselves. Customs may investigate when allegations are made that merchandise is imported or is likely to be imported in violation of section 307. In investigating a suspected violation, Customs commonly obtains information from sources that include foreign interests, importers, domestic producers, and others.

<sup>1</sup>[ch. 1244, 26 Stat. 567, 624 (1890)]

<sup>2</sup>Id. at 1233.

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**Appendix II  
U.S. Laws and Regulations Prohibiting  
Imports Made With Prison Labor**

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If the information reasonably indicates that the merchandise may fall within the purview of section 307, the Commissioner of Customs is to advise all district directors in charge of U.S. ports to withhold release of the merchandise. The importer must then produce a certificate of origin, signed by the foreign seller or owner, that contains sufficient information showing that prohibited labor was not used. If, despite the importer's evidence, there remains probable cause to conclude that certain merchandise is subject to the provisions of section 307 and consequently prohibited from importation, Customs is to publish its finding in the Federal Register. Such a finding must be approved by the Secretary of the Treasury. Once the importer has filed a protest with Customs and the protest has been denied, the importer can then file suit in CIT to try to overturn the Customs determination.

If Customs suspects that prison labor goods are being imported intentionally, Customs may refer the case to a U.S. attorney for criminal prosecution. U.S. law provides criminal penalties for the knowing importation or transportation in interstate commerce of convict or prison-made goods.<sup>3</sup>

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<sup>3</sup>Title 18 U.S.C. 1761(a) states: "Whoever knowingly transports in interstate commerce or from any foreign country into the United States any goods, wares, or merchandise manufactured, produced, or mined, wholly or in part by convicts or prisoners, except convicts or prisoners on parole, supervised release, or probation, or in any penal or reformatory institution, shall be fined not more than \$50,000 or imprisoned not more than two years, or both."

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# The Case of China Diesel Imports v. the United States

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## Background

In November 1991, the U.S. Commissioner of Customs issued a detention order advising all district directors to withhold the release of certain Chinese diesel engines that had been imported to the United States. The U.S. importer, China Diesel Imports, Inc., previously denied that the engines had been produced with prohibited labor. However, in January 1992, Customs determined again that the diesel engines had been produced with convict and/or forced and/or indentured labor and therefore should be denied U.S. entry according to 19 U.S.C. 1307. China Diesel filed suit in CIT on October 16, 1992, to challenge the protest denial and to assert that the diesel engines should have been allowed entry into the United States.<sup>1</sup>

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## China Diesel and the Standard of Review

Before CIT issued its first opinion in China Diesel, the Justice Department argued that the standard of review applied by CIT should be limited to the records used by Customs in making its determination. Such a hearing would be based on the Administrative Procedures Act (APA) (5 U.S.C. 706, 1988) standard of review, which is usually limited to the agency's compiled record.

On June 2, 1994, CIT refused to apply the APA standard of review and held that it must adjudicate all factual issues in this case. Such a proceeding is called a de novo review. In a de novo review, CIT would make its own findings concerning whether the goods in question were prison labor exports, and the importer would be able to introduce new evidence. Moreover, in a trial de novo, the rules of evidence might not allow admission of much of the informal testimony that was developed and related orally by Customs officials under the MOU. The testimony of government witnesses who spoke with Chinese prison inmates, for example, might be precluded by the rule against hearsay.

On December 7, 1994, CIT upheld Customs' right to exclude, under section 307, diesel engines manufactured in China. In upholding Customs' exclusion, CIT held that the importer had the burden of proving that the diesel engines involved in the case were not made, in whole or in part, with convict labor and that the importer had not met this burden. China Diesel Imports, Inc., did not file an appeal within the 60 days allowed after the CIT's decision.

In reaching its conclusion in China Diesel, CIT said that it had relied most heavily upon Chinese government documents and reference publications.

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<sup>1</sup>China Diesel Imports, Inc. v. The United States, No. 94-90, slip op. at 13 (CIT, June 2, 1994).

The documents appeared to identify the facility where the engines were manufactured as a "Reform through Labor" facility. CIT held that such facilities were penal, and the inmates who worked in them were convicts. CIT stated that these documents alone would have provided sufficient evidence to uphold Customs' determination. In addition, CIT stated that its conclusion was corroborated by (1) testimony of State Department officials that their tour of the Chinese facility had been staged, and by (2) failure of the Chinese factory manager to appear at the trial.

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### Other Issues Arising From China Diesel

CIT also reached two conclusions regarding the application of the consumptive demand clause of the 1930 Tariff Act. First, CIT held that the clause's exception of imported goods made with forced and/or indentured labor applies in instances when the product is not available and not merely, as the government argued, when domestic industry lacked the capability to produce goods in question. Second, CIT ruled that the consumptive demand exception does not apply to convict-made goods. This second conclusion was particularly significant, because previous courts had declined to decide whether importing a product produced with convict labor is permissible when domestic production is insufficient to satisfy domestic demand.<sup>2</sup>

In defending Customs' determination, Justice officials stated that the MOU was particularly useful to the presentation of the U.S. government's case. First, the Chinese government had arranged a tour of the facility according to the terms provided in the MOU. Second, because the MOU provides that each party furnish "available evidence and information regarding suspected violations of relevant laws and regulations in a form admissible in judicial or administrative proceedings of the other party," CIT allowed the Justice Department to draw inferences from the Chinese government's apparent unwillingness to allow the factory manager to testify. Justice officials explained that, were it not for the language of the MOU, the U.S. government would normally not have been permitted to argue that the failure of the factory manager to appear suggested that his testimony would be damaging to the importer's case.

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### Justice Officials' Concerns Regarding Future Cases

Despite the outcome of China Diesel, Justice officials still have concerns regarding their ability to gather evidence efficiently and inexpensively in section 307 cases under a de novo standard of review. They are concerned

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<sup>2</sup>See McKinney v. United States Department of the Treasury 614 F. Supp. 1226 (CIT 1985).

that the outcome of the case may have depended on certain circumstances that may not be present in future cases. These circumstances include

- (1) the availability of Chinese government and reference publications that identified the facility in question as a "Reform through Labor" facility. According to Justice officials, the Chinese government ceased identifying "Reform through Labor" facilities in its publications as of 1990.
- (2) the availability at trial of the State Department officials who conducted the on-site investigation. Justice officials explained that the U.S. government personnel who conduct the factory tour may not always be available to testify.
- (3) the paucity of evidence produced by the importer. Even assuming that future courts place the burden of proof on the importer, the U.S. government may nevertheless be required to produce evidence in order to refute evidence introduced by the importer.<sup>3</sup>

Finally, because different CIT judges may decide similar cases differently, the future application of CIT decisions is unclear until the issue in question is decided by the Court of Appeals for the Federal Circuit. Thus, despite the decision in China Diesel, it is uncertain whether CIT will apply a de novo standard of review in future section 307 cases.

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<sup>3</sup>Evidence which, if unexplained or uncontradicted, is sufficient to sustain judgment in favor of the plaintiff, is called prima facie evidence.

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