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China's Broken Promises

By Stephen Ezell

Its manipulation of its World Trade Organization commitments is damaging the global trading system.

When China entered the World Trade Organization in December 2001, pundits hailed China's accession as a pivotal moment that definitively heralded the country's shift toward a market-based economy. Observers were assured China was prepared to accept the fundamental principles upon which globalization rests: national treatment, nondiscrimination, transparency, and the primacy of rules-governed, market-based trade in accordance with the theory of comparative advantage. But almost fifteen years later, it's become clear that the promise has fallen short.

To be sure, China reformed thousands of domestic laws as it entered the WTO and has complied with many of its WTO commitments—such as joining the Information Technology Agreement and reducing average tariffs on industrial products. But all too often, one step forward has been met with two steps backward. China has erected new, often behind-the-border non-tariff barriers to more than compensate for concessions elsewhere. In many other cases—such as its practice of limiting market access or conditioning access on the transfer of technology or intellectual property, its ongoing subsidies for state-owned enterprises and export industries, and its failure to accede to the Government Procurement Agreement—China has simply failed to fully comply with its WTO accession commitments and membership requirements. Worse, modern Chinese economic policy is increasingly characterized by an autarkic approach that seeks absolute advantage across hundreds of high-technology products, from automobiles to

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semiconductors, including intentional strategies to curtail foreign imports of such products and replace them with Chinese-manufactured ones. This article puts Chinese economic and trade strategy in context, articulates several WTO commitments China has failed to uphold, and explains how policymakers in concerned nations should respond.

In the early 2000s, China's economic development strategy sought principally to induce foreign multinationals to shift production to China, but that approach changed in 2006 as the country shifted to a "China, Inc." model of "indigenous innovation" focused explicitly on advancing development of Chinese enterprises, often at the expense of foreign ones. Marking this shift was a seminal document,

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the *National Medium- and Long-Term Program for Science and Technology Development (2006–2020),* or "MLP," which called on China to master 402 key technologies, from intelligent automobiles and pharmaceuticals to integrated circuits and high-performance computers. Rejecting the notion of comparative advantage—which holds that nations should specialize in making products or services where they enjoy a relative production advantage—the MLP essentially announced that Chinese economic strategy now sought absolute advantage across virtually all advanced technology industries. Essentially, Chinese policymakers want to autarkically supply Chinese markets for advanced technology products with local production while still benefitting from unfettered access to global markets for their technology exports. That approach is apparent, for example, in China's "National Guidelines for Development and Promotion of the Integrated Circuit Industry," a $100 billion initiative which seeks to create a completely closed-loop semiconductor development and manufacturing ecosystem in China. The guidelines also unabashedly call for China to reduce imports of U.S. semiconductors by half in ten years and to eliminate them entirely within twenty years. Under this autarkic approach, China has fielded a wide range of mercantilist trade policies—virtually all of which it vowed to eschew when joining the WTO.

China's failure to follow through on many of the trade-liberalizing commitments it made in order to convince free trade-oriented nations to approve its WTO membership has harmed both the global trading system and economic growth in countries affected by China's mercantilist trade practices. China has failed to meet these seven top WTO commitments:

■ Refraining from requiring technology or IP transfer as a condition of market access.
Although China's WTO accession agreement contains rules forbidding the country from tying foreign direct investment or market access to requirements to transfer technology to the country, it remains commonplace to require that firms transfer technology in exchange for being granted the ability to invest, operate, or sell in China. As BASF Chairman and Chief Executive Jürgen Hambrech states, foreign companies doing business in China continue to face "forced disclosure of know-how." In 2015, China's government promulgated new rules to force foreign technology firms to surrender their source code (that is, proprietary computer programs) in exchange for access to Chinese banking and government procurement markets.

■ Joining the Government Procurement Agreement.
In joining the WTO, China agreed to join the GPA, which prohibits restrictions on government purchases between member countries and affirms that governments will make purchasing decisions on the basis of national treatment and non-discrimination. Despite tabling five proposals, China has yet to make a credible offer for GPA coverage, despite its commitment to do so swiftly in 2001.

■ Requiring state-owned enterprises to make purchases based on commercial considerations.
China agreed that it would "ensure that state-owned and state-invested enterprises will make purchases and sales based solely on commercial considerations." Yet these commitments fly in the face of explicit Chinese efforts to curtail Chinese government agency and SOEs' procurement of foreign enterprise-developed or manufactured information and communications technology products. Another manifestation of this is the Chinese government's scarcely concealed "De-IOE campaign," designed to pressure Chinese companies, especially state-owned enterprises, to replace their IBM, Oracle, and EMC products with Chinese-made products and services.

■ Substantially reducing export subsidies.
Although the Chinese government committed to eliminating or substantially reducing export subsidies (and particularly those for loss-making state-owned enterprises) as a condition of its WTO accession, subsidies to China's steel, energy, glass, paper, and auto parts industries have

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been particularly intensive—reaching over $110 billion in the 2000s for those five industries alone. Those subsidies have contributed substantially to global overcapacity in these industries.

■ **Significantly reducing intellectual property theft and violations.**
Joining the WTO required China to recognize the Agreement on Trade-Related Aspects of Intellectual Property Rights, which provides protections for patents, copyrights, trademarks, service marks, industrial designs, digital content, and other intangible property. Unfortunately, Chinese intellectual property theft grows unabated. The IP Commission Report on the Theft of U.S. Intellectual Property found that China accounted for nearly 80 percent of all IP thefts from U.S.-headquartered organizations in 2013, amounting to an estimated $300 billion in lost business annually.

■ **Abiding by the Technical Barriers to Trade Agreement and not manipulating technology standards.**
In joining the WTO, China agreed to abide by the Agreement on Technical Barriers to Trade, which prevents WTO members from using certifications and standards as barriers to trade. But China has made the development of indigenous technology standards, particularly for information and communications technology products, a core component of its industrial development and economic growth strategy.

■ **Refraining from currency manipulation.**
China's membership in the International Monetary Fund commits it "to avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members." But a July 2012 policy brief published by the Peterson Institute for International Economics identifies China as one of the world's twenty "most egregious" currency manipulators over the first decade of this century. China's continuing competitive undervaluation represents a *de facto* subsidy to all exports and a tariff on all imports that both lowers global economic welfare and puts China in contravention of commitments it has made to the global trading system.

In short, it's clear that China will not fully comply with its WTO commitments and that its use of mercantilist trade practices will not abate until other nations make clear this is unacceptable and not concordant with China's responsibilities. Yet too often American and European policymakers have taken a "wait and see" approach, arguing that China is just learning how to be a market economy and needs more time. But Chinese officials know how to make China a market-oriented, rather than mercantilist, economy; they just do not want China to be one. Other policymakers have taken a "harangue and implore" strategy, in which U.S. policymakers express their concerns to Chinese policymakers through channels such as the Strategic and Economic Dialogue and hope China will respond desirably.

But these approaches won't work. What's needed instead is a strategy of "constructive confrontation," backed with true resolve, that emphasizes a results-oriented trade strategy with China. Such a strategy should seek to commit China to significantly reducing its global trade surplus, to rebalancing its economy from export-led growth to greater domestic consumption, and to letting foreign competitors compete in China's market on a truly nondiscriminatory basis. It should have real consequences, including not inviting China to participate in a new Bilateral Investment Treaty with the United States or new multilateral trade agreements such as the Trade in Services Agreement or Trans-Pacific Partnership Agreement until China fully complies with its WTO commitments. And it should give U.S. policymakers new tools for trade strategy and enforcement, including naming a chief trade enforcement officer, establishing a National Industrial Intelligence Council, and reforming the charter of the Committee on Foreign Investment in the United States to address the realities of modern-age state capitalism.

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The rules of the global trading system, embodied in the WTO, were designed to create mutually shared global prosperity. A prosperous China is desired by all, so long as that prosperity does not come at the expense of other nations or their enterprises. ◆