Trade Delivers

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WTO Case Challenging Chinese Subsidies

"We are fully committed to leveling the playing field for U.S. manufacturers, small businesses and workers."

- Ambassador Susan C. Schwab, United States Trade Representative

What Chinese Policies are at Issue?

China maintains a number of measures that benefit Chinese companies and companies in China with some amount of foreign investment (commonly known as foreign-invested enterprises or FIEs):

- Income tax reductions and refunds available to companies that satisfy certain export performance requirements
- Value-added tax (VAT) exemptions available to companies that satisfy certain export performance requirements
- Tariff exemptions available to companies that satisfy certain export performance requirements
- Discounted lending rates available to companies that satisfy certain export performance requirements
- Exemptions from mandatory worker benefit contributions available to companies that satisfy certain export performance requirements
- Income tax refunds available to companies that purchase Chinese-made equipment and accessories rather than imports
- VAT refunds available to companies that purchase Chinese-made equipment and accessories rather than imports

What WTO Requirements Apply?

- World Trade Organization (WTO) rules identify two kinds of subsidies that are so trade distorting that they are prohibited outright:
  - Export subsidies -- financial incentives that encourage firms to export their products; and
  - Import substitution subsidies -- financial incentives that encourage firms in a country to purchase domestic instead of foreign goods.
- China committed to eliminate these types of prohibited subsidies by the time it joined the WTO in December 2001.
- In the WTO dispute being brought by the United States against China, the United States is seeking the elimination of both kinds of prohibited subsidies.

How Do These Subsidies Tilt the Playing Field?

China's subsidies can distort trade conditions for U.S. manufacturers, small and medium-sized enterprises (SMEs) and their workers in multiple industries. They are available across manufacturing sectors, so they can inhibit U.S. exports of a huge range of products to China, and provide an unfair advantage to China's exports in the United States and around the world.

- **Export Subsidies: Push Exports from China** – The subsidies being challenged go to foreign-invested enterprises (FIEs) that meet certain export performance requirements. FIEs accounted for nearly 60 percent of China's exports of manufactured goods in 2005.
    - The vast majority of FIEs that are focused on exporting goods have corporate ties to countries neighboring China.
        - Many Asian companies appear to have moved their final assembly operations to China since China's accession to the WTO.
- **Import Substitution Subsidies: Discourage Purchases of U.S. Products –** Other challenged subsidies provide generous incentives for companies in China if they buy certain types of domestic products rather than imports from the United States or other countries.
- **Hurt Small American Manufacturers –** SMEs represent 40% of the value of U.S. manufacturing production and approximately 60% of U.S. manufacturing jobs. Approximately 90% of U.S. exporters to China are SMEs, which account for over 35% of U.S. merchandise exports to China.
    - Every sale lost to subsidized products disproportionately impacts SMEs and can threaten a company's continued financial viability, given the smaller size of SMEs and more limited financial resources.
    - The subsidy programs in question provide large reductions in tax, tariff, finance and equipment costs to certain producers and exporters in China.
    - SMEs face particularly acute pressure from subsidized products as they compete against imports in the U.S. market and for export sales in other markets.
- **Create an Unfair Advantage for China** – The Chinese subsidies at issue are widely available and offer significant benefits, particularly through income and value-added tax breaks. They make it harder for U.S. products to compete with Chinese products – not only in the U.S. and Chinese markets, but in any market in the world. They accomplish this by providing a competitive advantage to a wide range of Chinese exports—including, for example, various steel products, wood products such as hardwood plywood, and paper products—and by providing incentives for Chinese firms to purchase domestic products instead of those from the United States.

Why Pursue WTO Dispute Settlement?

- The United States is committed to fairness in the international trading system. This includes ensuring that China abides by the same rules that are applicable to other WTO Members.

- The United States sought to engage the Chinese in negotiations to arrive at a resolution. Those negotiations unfortunately failed to resolve the dispute. As a result, the United States today took the first step to bring this case before the WTO.

- Under WTO dispute settlement procedures, the United States and China would normally consult within 30 days. The United States hopes that these consultations will produce a satisfactory result. If they do not, then anytime after 60 days from the request for consultations, the United States has the right to request that the WTO establish a dispute settlement panel to examine the matter.

- WTO dispute settlement rules have facilitated and are assisting us in the resolution of other trade disputes with China:

    - March 2004 – After the United States filed a WTO dispute against China challenging value-added tax rebates that discriminated against imported semiconductors, the United States and China resolved the matter during the consultation phase, ensuring fair access to a market worth over $2 billion to U.S. manufacturers and workers in the semiconductor industry.

    - January 2006 – The United States and China resolved a dispute involving China's Imposition of antidumping duties on kraft linerboard shortly after the United States informed China that it would soon be filing a request for WTO consultations. China eliminated the antidumping order on kraft linerboard, terminating the unfair barrier to U.S. paper products and benefiting U.S. kraft linerboard mills in 14 states.

    - March 2006 – The United States, the European Communities and Canada have brought panel proceedings at the WTO challenging Chinese regulations that impose *de facto* local content requirements in the auto sector through discriminatory charges on imported auto parts.

Background on China's Subsidies

In April 2006, China submitted its first subsidies notification to the WTO, more than four years after its accession to the organization. China identified some of the subsidies at issue in that notification, but did not indicate any intent to withdraw them. The other subsidies at issue were uncovered through investigatory work by the U.S. Government, working with U.S. industry.

The U.S. consultations request addresses nine subsidy programs. Six of the challenged subsidy programs appear to be export subsidies, granted on the condition that the recipients meet certain export performance criteria. The remaining three subsidy programs appear to be import substitution subsidies, conditioning the grant of subsidies on the recipient's purchase of domestic over imported goods. Export subsidies and import substitution subsidies are prohibited under the WTO Agreement on Subsidies and Countervailing Measures. By conditioning financial incentives on an enterprise's purchase of domestic over imported equipment, the three import substitution subsidy programs also appear to treat imported products less favorably than domestic products, which would be inconsistent with the GATT 1994 and the WTO Agreement on Trade-Related Investment Measures.