

**Press Conference Announcing a Resolution to the WTO Dispute
Regarding China's Tax on Semiconductors
US Trade Representative Robert B. Zoellick**

July 8, 2004

USTR ZOELLICK: In March of this year President Bush authorized us to file the first ever case against China in the World Trade Organization, charging that China was unfairly providing special tax treatment to semiconductors produced in China and discriminating against U.S.-made integrated circuit chips.

Today, less than four months after filing this case I am pleased to announced that effective immediately China will not certify any new semi-conductor products or manufacturers for eligibility for the value added tax or VAT refunds. China will no longer offer VAT tax refunds that favor semiconductors designed in China and, by April 1 of next year, China will stop providing VAT tax refunds on Chinese produced semi-conductors to current beneficiaries. I'd like to thank our Chinese colleagues for working cooperatively with us to solve this problem and, of course, I would like to thank the team that we have here Josette Shinner, John Veroneau, the General Counsel, Charles Freeman and David Weller who has been working for both the China office and the General Counsel's office in our new efficiency, get two for one. VAT is a success that helps us level the playing field for US semiconductor firms selling chips in China. It's a decision that means that fair treatment for America's high tech exports in a very large but fast growing Chinese market and it is a another step forward for us with a long list of real results produced by this administration's trade enforcement strategy. China is the fastest growing market for our industry worth some 2 billion dollars in semiconductor exports last year. As I am sure some of the industry representatives here can tell you, China is a voracious consumer of semi-conductor chips which are both the brains and the engines of everything from PCs to cell phones to refrigerators to automobiles. So continued access to this market is vital to the health of the US semiconductor makers and that is why we have had a chance to work very closely with the industry to produce today's successful results. We really appreciate their support and I appreciate them being here with us.

GEORGE SCALISE, PRESIDENT OF THE SEMICONDUCTOR INDUSTRY

ASSOCIATION: Mr, Ambassador, first of all I'd like to congratulate you and the team on this excellent effort. It is one where the industry and the government worked together to solve a problem that has been very important to the industry and we really appreciate that. This wafer that I am handing you has more compute capacity than all the compute capacity that existed in this country in 1970, this one wafer and we produce, probably 200,000 of these wafers every month today. So I give you some idea of the kind of product that we are putting out today and what it does in terms of providing greater information technology capability on a broad spectrum of products. On each one of these (unintelligible) there are about 100 million transistors. When we first started we had one on each one. So we have made a little bit of progress over the years. The other thing that I want to point out here is how important this is to continuing to enhance the technology leadership that the semiconductor industry has here in the US. We now have, and have had for many years, over 50 percent of the world wide market and we plan to continue to

have that kind of market leadership. In addition to that about 70 percent of our manufacturing of high technology wafer capability is here in the US and with that about 70 percent of our employees. So we are going to continue to make investments as a consequence of this agreement and we will continue to employ more people here in the US again, thank you very much

ZOELLICK: I'm not going to hold this very long because it is worth about the price of a Corvette which is way beyond my government compensation but I was trying to think as George was referencing this, in 1970, which he said this does more computing power than the United States had in total, is the year I took my first programming course and I must assume that my computing capability at that time was not very high either so it does show some advancement. Fortunately other people went into this business so it is a good example of American ingenuity, but equally important, the jobs that these gentlemen and their colleagues are performing.

Here is the problem that we solved together. US exports of semiconductors to China have been subject to a 17 percent value added tax and then China taxed domestically produced or designed chips significantly less because it provided a substantial tax refund, up to 14 percent of that 17 percent. In our view that was inconsistent of WTO rules and put the US made chips at a competitive disadvantage. This policy also had broader implications for us so we believe that today's success has broader benefits. We view the VAT as an example of a problematic Chinese tax program, not just for the semiconductor (unintelligible), but across the range of China's economy. We want to send a signal that discriminatory taxes should not be used as a tool of industrial policy to favor domestic industries.

This result today is just one example, one part of the Administration's clear eyed approach to the China trade. We've been steadfast in insisting that China needs to play by the rules of international trade and we've not hesitated to use a full range of tools at our disposal to make that happen. In many sectors of the US economy, from soybeans to cotton from insurance to express delivery services to software, telecommunications equipment, other high tech products we've produced real results that have increased sales to China. Just this past Spring, for example, we were able to solve seven potential WTO cases through serious discussions and problem solving. This involved months of detailed work with people to my left here who worked with US industries and Chinese officials with a host of ministries culminating in a meeting that we had last April with Chinese Vice-Premier Wu Yi who has lead China's efforts. We produced real results that will improve China's protection of intellectual property, foster the sale of farm products to China, keep open the market for wireless Internet computing and insure technology neutrality in China's deployment of next generation of cellular telephone networks. With the help of our Chinese colleagues this problem solving approach often works, but, when warranted, we've not hesitated to use the other tools at our disposal. In the semi conductor case, this was the first ever WTO case filed against China and today's announcement shows that this multifaceted approach can produce real results.

It is also a good story in the numbers, U.S. exports to China are surging. Last year US exports to China were almost \$30 billion making China our sixth largest market. And exports so far this year are up 40 percent. After we solved problems of agricultural barriers to US trade our sales of soybeans and cotton jumped dramatically. US sales of soy beans were up 190 percent last year

to \$2.9 billion. Cotton was up 423 percent to \$737 million. Of course we know we will continue to face problems so we need to continue to remain vigilant.

Indeed, our overall trade enforcement strategy is about a lot more than just bringing law suits and procedural moves. It is about trying to produce real commercial results with whatever tools are right for the job. So from Asia to Africa, from the Middle East to Mexico we have tried to use the full range of tools at our disposal. Often we have been able to solve problems through creative discussions and creative approaches. Sometimes we are able to incorporate them into the ambitious agenda we have of our bilateral trade negotiations or Free Trade Agreements, and sometimes we take action at the WTO.

So we have opened markets for America's high tech, American hogs, we have fixed problems dealing with cell phone technology in East Asia, American cars in India, and American copyrights in Latin America. But whatever the tool, the focus is the same to try to concentrate on real results that increase trade, level the playing field and produce opportunities for Americans to compete in a growing world economy. Thank you very much. I'll be happy to take some of your questions.

QUESTION: Pete Kasperowicz from Inside US Trade. I do not know if you could introduce this George guy who gave you this huge wafer. I didn't know who he was.

SCALISE: I am George Scalise, President of the Semiconductor Industry Association.

QUESTION: China was known to be reluctant to reach any kind of accommodation on this issue, which is why you went for consultations in the WTO in the first place. What turned the tide, what sort of brought them around? Was there anything in particular, was there any sort of trade off or any other kind of arrangement that the US would make in return?

ZOELLICK: Well, we thought we had a very strong case because, from Inside US Trade as you know, there is a principle of national treatment where you have to treat foreigners the same as domestic. The original agreement on the China side was they treat American companies within China the same as Chinese companies, but that is not the critical national treatment principle because we wanted to make sure that manufactures in the United States also have ability to add to that \$2 billion in exports and the jobs that's created. So, we presented that to the Ministry of Commerce and they had to also work with some others. We had frankly wanted to try to resolve this at a point earlier but we couldn't get the process and so we then used the leverage of taking the WTO action. What we had communicated to our Chinese colleagues is that if we did not solve the problem by today we would take the next step of asking for the panel. So we now are able to solve that problem together and avoid it. So I want to, as in any country when people deal with these problems there are industries that have vested interests and so it also took some effort by our colleagues in the Chinese MOFCOM to try to help work through on their side and we are very pleased with the result as is our industry. Because, again the key point is the US-China trade offers benefits for both sides and we see this as an opportunity market as these companies do. We just want to make sure it is a level playing field.

QUESTION: Neil King, Wall Street Journal. I just want to ask two things. One is if you can elaborate a little bit on the distinction between the designed end as opposed to the produced end and which, sort of, was the nub of the problem? I do not know whether there is a sense of what the proportions were. The other one: this real results thing which is up there about one hundred times and I think that you have said about one hundred times, seems slightly defensive. I am just curious about what this infinite repetition of “Real Results” is meant to highlight. It must have been that you are sort of defensive that people are acting as if you have not achieved “Real Results” so you are trying to hammer home that you have. I am just curious what the background of this is.

ZOELLICK: Well, let me explain the first point. On the first point there were different aspects of the Chinese policy that we had to deal with and one is they would give a certain possible tax advantage to semiconductor chips that could be designed in China but China did not have the capability to manufacture yet, they would be manufactured outside of China. We felt that any of these tax advantages would be discriminatory and so that is one that they had to agree to end that was part of their regulations and they were just proceeding with.

That is separate for the discriminatory tax for semiconductors that were manufactured in China. Now as soon as we threatened to take the action to the WTO and started to take the action, you started to see a drop off in investment in China that was getting the advantage of this special tax advantage. So that occurred with the bringing of the action. So the three parts that I mentioned today being that they are not going to have any more approvals for either the benefit of the tax for designers or manufacturers and for those that currently have the benefit, that will be phased out by April 1. So those are the three components overall.

Now the point of real results, Neil as you know, I believe that it is appropriate for US officials to articulate and defend the policy and that’s part of what public debate is about. There have been some that have tried to measure the success of enforcement strategies simply through cases that have been brought. That’s not been our approach. We have a fact sheet here that emphasizes that they way that we believe that you can solve problems, not only with China, but across the overall horizon is through a combination that focused on the outcomes of real results, not just the number of suits that you bring. We have tried to do in part of what I think is an appropriate public explanation is explain how these are intergraded together.

The China relationship is a good example because what we emphasized at the time of the JCCT meeting is that we have seven results that we could have brought in WTO action time. Somebody wanted to increase the overall numbers, we could have brought more action. But, we got results more quickly. In this one we were not able to get results so we did bring an action but that did not stop us from trying to solve a problem before having to go through the year or year and a half long process with the WTO so within four months we were able to get the results. So it is up to you and others to judge whether these are the product and the real results but we are just trying to present the facts and explain the logic which I think is part of the neutral public debate.

QUESTION: (Corbett Daly, CBS Marketwatch). You said that there are some who are bringing the number of cases. I think there is no surprise to anyone in this room that you are referring to

your political opponents in the November election. I am just wondering if you could tie this and today's decision. How much do you think that trade and manufacturing is going to be a factor coming up in November?

ZOELLICK: Well, what we've been trying to do for three and a half years is use the full array of Free Trade Agreements, enforcement actions, work in the WTO, a whole host of problem solving to level the playing field and open markets. And we are very proud of the record that we have had on that. Just today we are making progress on moving forward the Australia Free Trade Agreement which the National Association of Manufacturers estimates will be an extra \$2 billion of exports. This is a market that we already have a substantial surplus in, it's a major trading partner. If you look at the services trade it is almost approaching the manufacturing trade. So there is a host of ways in which we are trying to open markets for the United States.

That is based on a fundamental belief that if we can create a level playing field and allow Americans to compete, they can compete with anybody. Now, there are others who have taken what we describe as an economic isolationist, a more pessimistic view of trying to block US markets. We have people who have not stood up for the extension of the overall trade negotiating authority that the president fought so hard for, President Clinton fought hard for but couldn't get. We got it, we are moving the agenda forward. So we believe that the United States, and this is an industry that certainly demonstrates it, can be major manufacturers, major designers, a major part of R & D for the future and that it is a win possibility globally. That is what we have worked on and that is what we will argue over the next month.

QUESTION: Chris Rugaber, BNA Publications. Notwithstanding what you were saying about the different strategies that you guys have taken toward China. Some have argued that you have not been tough enough. Given that there are still some problems out there such as intellectual property rights which seem somewhat impervious to negotiating a solution and given the results that you now have from having fought this WTO case or having initiated the process should we expect perhaps, for you to be more likely to bring a WTO case in the future giving the outcome of this one.

ZOELLICK: In that area or other areas?

QUESTION: IPR or others.

ZOELLICK: Well, we always keep open the option of WTO cases. There is one that we have been talking with the Chinese now as have the European about China's coke exports which they have restricted which affect a lot of the US industries. We are getting a sense that China wants to resolve that problem short of litigation. If we can it is a good result, if we can not, we will not hesitate to take to litigation.

In the intellectual property rights area. One of the areas that Ambassador Shiner and other spent a lot of time on a lot of trips to China, is trying to focus on what much more specific actions does China need to take in terms of lowering the criminal thresholds, increasing the crack downs and focusing on the judiciary's role, a number of aspects to make intellectual property system work much more effectively. The sense we're getting is that the Chinese are following through on that

commitment but it will only be with China. We obviously have to do this with Brazil, we have to do this with Russia, we have to do it in our own country. So we do not foreclose the possibility of WTO actions but at present, and Secretary Evans was just over in China, we are seeing the follow through but we are going to keep vigilant. I should look back on this.

QUESTION: Ted Alden from the Financial Times. Since you have explained this issue so well I wanted to ask about another matter. Boeing has been raising the rhetoric as Harry Stonecipher put it, on European subsidies to Airbus. Do you believe that the Europeans are abiding by the 1992 Aircraft Agreement and if they are do you believe that that agreement is one that needs re-negotiating in the light of concerns raised recently by Boeing?

ZOELLICK: I would actually expand the question. It's not only a question of the '92 agreement, it is a question of their WTO obligations and that's an issue which has been discussed with the Europeans and we have been discussing with Boeing. Each company has a different strategy and, frankly, what Boeing is trying to get in terms of a level playing field is the recognition that, it believes that it's plans for the 7E7 or successful business strategy and it does not want Europe to add more financing for an alternative to the 7E7 or difficulties with the 380. And frankly, if there were ever a justification in '92 or earlier for a startup industry that has long been overcome. And so that's a point that we are urging on our Europeans so they spend less wasteful subsidies along with, of course you've seen their effort to try to clear up subsidies for their corporate restructuring, this is another way to cut subsidies.

QUESTION: Ted Alden. Would that require tightening the measures going forward, you're talking about alternatives to the 7E7, that's why I ask about renegotiating the '92 agreement.

ZOELLICK: That would require trying to fix the problem.

QUESTION: Jim Berger from Washington Trade Daily. Talking about real results you have quit a few agriculture trade issues unresolved on the platter which I guess you will take up Saturday in Paris. What's the prospects...can these be resolved by the end of the month so the Doha Round can go ahead to completion sometime?

ZOELLICK: Well, just to step back on that for a minute. The reason that I wrote the letter in January and took the trip in February and I have taken the other actions all throughout the year is that we think there is a tremendous opportunity here to achieve some very substantial reform in international agriculture system. Part of that is eliminating export subsidies which would be a historic achievement, very significant cuts in domestic subsidies. Europe's are much larger than ours but we will take significant cuts if they do but it also has to be connected to opening markets. The WTO is about opening markets to agricultural goods and services. We see an opportunity, and I don't know whether others will see the same opportunity. It is a challenging period. It is always difficult to bring 447 players together in the process. After I go to the meeting of the 5 countries in Paris I am headed off to Mauritius to meet with the G90, a number of the poorer countries. So we will make every effort but we are just one player in the process and the main point for me, I guess, is that it would be a shame, given the fact that at least in this country this administration is willing to take significant steps to open markets. People thought that, going back to the question of election year, nothing would happen, we are forging ahead the

Australia agreement, I have the King of Morocco here today, we are moving ahead with Morocco, we are closing other agreements, we are solving these sorts of problems, so we are there and I wish I could assure you that others will be, I just do not know. You are getting different signs out of different places. And I complimented Commissioner Lamy's effort but clearly we have seen some push back in some member state capitals on these issues and there are some meetings in Europe on these topics that are being called because some of the forces in European agriculture that don't want to move are now making their presence felt, so we will just have to see how that works out.

QUESTION: Elizabeth Becker of the New York Times. Just to round out the Real Results discussion. One of the complaints is that the trade deficit has gotten worse under this administration and that is the result that people are interested in. Will this, first of all, help the trade deficit and secondly, in the larger discussion of Real Results how do you answer that question about the worsening trade deficit?

ZOELLICK: On the narrow point as I had mentioned we have about 2 billion dollars of exports here in a market that we see growing and expanding so we believe that by reducing the discriminatory nature you will get the benefits of growth but you will also get the benefits of offsetting the discrimination. Now how much depends on factors in that market. Maybe others here will have a better sense of that than I could but those are pretty good numbers. Again it is one piece. I mentioned \$2.9 billion in soybean sales the cotton numbers for the first quarter were higher than they were for all of last year so you are seeing some substantial increases.

But in terms of the trade deficit. What the overall trade deficit reflects is the fact that the United States is buying more than other countries are buying and that is in part because we have been growing more. And so, I look back to the period in 1991-'92 when the trade current deficit was about zero was because we were in recession. So the solution to that problem is a combination of opening markets and getting more growth around the world that brings us back to the China case. China's growth gives us a lot of opportunities but to seize them we need to make sure it is a level playing field.

Do any of you have any comment on that?

SCALISE: One comment that I would make with regard to the semiconductor market in China, as the Ambassador said, it is a very large market at about \$25 billion. It is growing at about a 25 percent compound annual growth rate and we have the largest share of that market, about \$2 billion of it right now, largest share of foreign supplier, only because most of the product is much older product that they are using in China it is not the newer products. As they continue to move up the scale they will be buying more and more from us so we are going to take advantage of the growth that is taking place in that market.

QUESTION: (Unintelligible)...exporting to China particularly on the export control side. Has the US imposed a restriction or slowed down imports?

ZOELLICK: Do you want to give your name and association?

QUESTION: Sam Gilsten with Washington Tariff and Trade

SCALISE: Well two points I would make. First of all the one made earlier in regard to intellectual property is a very important issue because again, in this industry it may cost today upwards up \$20 million to design a product. You can replicate that product through some nefarious means for about \$100,000 and so making certain that intellectual property is being honored is number one.

There is an issue that has been a problem for some degree and that is the restriction on equipment that goes into China and they do complain about that. However at this stage we think that that is getting worked though and time moves along and the next level of equipment is allowed to go in, I think that problem is a relatively small problem. It's not something that creates any great deal of discontinuity.

ZOELLICK: Just to add to that one of the other items that we dealt with at the time of the JCCT meeting and this was done by Under Secretary Ken Juster of the Commerce Department was to get agreement with the Chinese on an end user regime just as we had with India that I think will be very important in terms of trying to deal with some of the high tax exports and export controls.

My colleague has overruled both of us because there is a reporter from Hong Kong that I need to...our open, international policy.

QUESTION: Thank you, I'm Nai-ching Katz with Phoenix TV of Hong Kong. Can update us with your talks with China, the question of China trying to acquire the market economy? Also is there a specific framework or set of criteria the US has with China to resolve the problem?

ZOELLICK: The market economy status decision in the United States is determined by statute and there are six criteria, five of them specific, one general that the United States needs to evaluate and determine whether it makes a rule of the country as market economy. That is a decision for our Commerce Department and that's one of the reasons that Secretary Evans was in China. He brought a team with him to talk about those criteria and the working groups to examine China's qualification for that. They are all possibilities and this is again, done by the Commerce Department that the key relevance of this is for antidumping suits. Whether in an antidumping suit if it is a market economy you use the cost facture of the economy otherwise you look outside. But as you saw in some of the recent dumping actions related to furniture and others, the most recent one was shrimp, where the Commerce Department can determine that a certain company or part of a sector is not influenced by the government than it will use the local costs and this is why you have some of the disparities in terms of these antidumping duties that were determined. So there is the overall determination of the Commerce Department also that makes specific adjustments in some of the particular cases. So that is something that we know is important to China, that is one of the reasons that Secretary Evans led that follow up along with Secretary Chao on the labor issues.

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