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China To End Subsidies Challenged by the United States in WTO Dispute

WASHINGTON (Nov. 29) – U.S. Trade Representative Susan C. Schwab today announced that China has agreed to terminate subsidies that the United States alleged were illegal under World Trade Organization (WTO) rules.

“I am very pleased that today we have been able to sign an agreement with China that should lead to full elimination of these prohibited subsidies. This outcome represents a victory for U.S. manufacturers and their workers. The agreement also demonstrates that two great trading nations can work together to settle disputes to their mutual benefit,” said Ambassador Schwab.

“Earlier this year, when China had not removed these market-distorting subsidies after we repeatedly voiced our concerns about them, the United States took action. This outcome shows that President Bush’s policy of serious dialogue and resolute enforcement is delivering real results. While many challenges still remain, today’s news is concrete and welcome.”

The Memorandum of Understanding (MOU) is designed to settle a WTO case the United States and Mexico initiated in February of this year. The United States had alleged that China was maintaining several subsidy programs prohibited under WTO rules and that these programs were providing significant benefits across the spectrum of industrial sectors in China— including steel, wood products, information technology, and many others. Mexico also filed as a co-complainant.

Most of the challenged subsidies were tied to exports, giving an unfair competitive advantage to Chinese products and denying U.S. manufacturers the chance to compete fairly with them in the United States and in third country markets. The remaining subsidies, known as “import substitution” subsidies, encouraged companies in China to purchase Chinese-made goods instead of imports. These subsidies were designed

to give Chinese-made goods a significant edge in the Chinamarket over high-quality, fairly priced goods from the United States and other countries.

Under the MOU, China has committed to complete a series of steps by January 1, 2008 to ensure that the WTO-prohibited subsidies cited in the U.S. complaint have been permanently eliminated, and that they will not be re-introduced in the future. U.S. companies and workers will benefit from the removal of China's trade-distorting subsidies much sooner than would have been possible if the United States had litigated this case to its conclusion. At the same time, if for any reason China does not meet its MOU commitments, the United States has the right to re-start WTO proceedings.

Background:

The United States initiated the dispute over China's prohibited subsidies at the WTO by requesting consultations with China on February 2, 2007. Mexico requested consultations with China on the same measures on February 26, 2007. Following two rounds of consultations, in March and June of this year, the United States requested in July that the WTO establish a dispute settlement panel to hear its claims. The WTO established a panel in late August.

Most of the subsidies we challenged are tax breaks benefiting foreign-invested enterprises, which are any firms with even a small amount of foreign investment, and were made available in every manufacturing sector.

According to a February 2006 Trade Policy Review report prepared by the WTO Secretariat, 58 percent of exports of manufactured goods from China came from FIEs in 2005, and that figure is growing.

Because these tax breaks are automatically available to the eligible enterprises, it would appear that a large amount of China's exports have been benefiting from these pervasive subsidies.

This is the fifth dispute that the United States has brought against China at the WTO. The first one, brought in 2004, challenged China's discriminatory tax treatment of imported semiconductors and, like the prohibited subsidies case, was resolved through a settlement where China removed the offending measures. The other three cases are currently pending before the WTO.

The United States, together with Canada and the European Union, requested a panel in September 2006 to examine China's regulations imposing local content requirements in the auto sector through discriminatory charges on imported auto parts. WTO panel proceedings in that dispute are underway.

The United States also requested a panel in August 2007 to examine deficiencies in China's legal regime for protecting and enforcing copyrights and trademarks on a wide range of products. The WTO established a panel in September and panel proceedings are in progress.

In October 2007, the United States requested the WTO to establish a dispute settlement panel in a case challenging China's restrictions on the importation and distribution of products of copyright-intensive industries such as theatrical films, DVDs, music, books and journals. A panel was established for this dispute on November 27, 2007.

Remarks by U.S. Trade Representative Susan C. Schwab

Announcement of Resolution of WTO Dispute With China on Prohibited Subsidies

November 29, 2007

Introduction

- Thank you all for coming.
- As many of you know, in February of this year, we filed a case in the World Trade Organization challenging China's illegal subsidies practices.
- This case is enormously important. It challenged the kinds of illegal subsidies that severely distort trade conditions for U.S.manufacturers and producers – especially small and medium sized enterprises – and their workers. As a result of such subsidies, a range of domestically produced goods in the United States, from steel to wood products to information technologies, are denied the opportunity to compete fairly in the United States, in China, and in third country markets where they are up against Chinese subsidies that are illegal under the WTO.
- Today, I am very pleased to report we have just signed an agreement with China that will lead to complete elimination of these WTO-prohibited subsidies. We expect the agreement to be fully implemented by January 1, 2008.

This outcome represents a victory for U.S.manufacturers, producers and their workers. It is significant in three respects. First, it eliminates a set of widely- available subsidies that create significant disadvantages for U.S.products across many manufacturing sectors. Second, it shows that Chinese policymakers understand the need to respect the strict WTO prohibitions on these kinds of subsidies in the future. It also demonstrates that our two nations can work together to resolve major differences. Third, it shows that President Bush's approach to resolving trade disputes with China– dialogue if possible, legal action when necessary, and working within the rules-based system - gets real results.

U.S. Approach Works

- In this case, as in others, we have been clear: Where China fails to live up to its WTO obligations, we will use the full array of tools available to secure compliance.
- We began by engaging China in dialogue, but it became clear that dialogue alone was not leading the Chinese government to address our concerns. So, we invoked the WTO dispute resolution process. At the same time, we made clear our preference for the right result - and not simply drawn-out litigation for its own sake.
- The result? A pragmatic outcome from the WTO dispute settlement process with the excellent result that I am announcing today.

Specifics of the Case

- From a legal perspective, this case is relatively straightforward.
- We were prepared to prove that China had been violating WTO subsidies rules by continuing to use two broad types of prohibited subsidies across the spectrum of industry sectors in China – including steel, wood products, information technology, and many others.

- First, export subsidies – these subsidies have given an unfair competitive advantage to Chinese products and denied U.S. manufacturers the chance to compete fairly in the United States and in third country markets.
- Second, the Chinese will eliminate “import substitution” subsidies. These subsidies have encouraged companies in China to purchase Chinese-made goods instead of imports. They have given Chinese-made goods an unfair edge in the China market over high-quality, fairly priced goods from the United States and other countries.
- These two types of subsidies – export subsidies and import substitution subsidies – are considered to be “prohibited subsidies” by the WTO. That means they are so trade-distorting that WTO rules prohibit them outright.
- But, the Chinese government has been slow to emerge from its historical role controlling the economy. We have been urging China to eliminate all industrial policies, like these prohibited subsidies, which interfere so fundamentally with market-driven economic and trade outcomes.

Trade Impact

- At its core, this case was about standing up for American manufacturers and workers. The trade-distorting subsidies we challenged created significant disadvantages for U.S. products in our home market, in China, and in third country markets.
- The prohibited subsidies that China has now agreed to discontinue were widely available across many manufacturing sectors in China, and they offered sizeable benefits.
- For example, the export subsidies included benefits like substantial income tax reductions that had the potential to benefit up to 60 percent of China’s exports.
- It is difficult for companies to compete when the playing field is so uneven. It is especially hard on small and medium-sized enterprises and their workers.
- China’s renunciation of the banned subsidies we challenged is excellent news for China as a WTO Member and excellent news for world trade. In this area, we will now have a more level playing field – a direct benefit of the rules-based system.

U.S.-China Trade Relations

- I want to underscore that the way this dispute was resolved stands as a victory for both countries. It demonstrates that mature trading partners can use the WTO process to work through their differences.
- The United States is also encouraged that the terms of the agreement reflect a conscious decision by China – for its own benefit – to reject the economic thinking that has relied on these kinds of distorting subsidies in the past. That is good for China as a WTO member and good for the world at large.
- We face many challenges in our trade relationship with China, and this is only one aspect. But it is an important one. There is still much work to be done to meet the challenges of our growing and complex relationship with China – and it will be difficult work. More results are needed, and at a faster pace.

Conclusion

- Let me make two final points before I conclude.
- First, I would like to note that I have consulted closely with Congress as we have developed strategies for dealing with difficult issues like prohibited subsidies, and Members with whom I have spoken appreciate the value of results over rhetoric.

I think this announcement makes clear that the Administration's policy of serious dialogue and resolute enforcement is delivering real results. It clearly shows the wisdom of this approach over some legislative approaches that would simply impose retaliatory tariffs.

What we have done will actually benefit U.S.manufacturers and workers. What we should avoid is a needlessly hostile relationship with China which will, in the long run, only hurt U.S.workers and consumers.

- Second, I want to express my appreciation to the Government of Mexico, our co-complainant in this case, and in particular Minister Eduardo Sojo, for working with us so closely on this dispute at the WTO.
- Thank you. I would be happy to take your questions.

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