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The U.S. Must Face Up to China's Trade Challenges

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China has been a member of the World Trade Organization (WTO) for almost two years, but is still dragging its heels on fulfilling its WTO commitments. If it were a smaller economy, some of China's transgressions could be tolerated, but when the world's fourth largest trading nation ignores its obligations, China's trading partners ought to act.

One thing is clear: China will not change its behavior unless it faces credible prospects of retaliation. Therefore, persuading China to comply with its WTO obligations will take a combination of economic leverage and diplomatic pressure.

The U.S. Response

Aside from the panoply of retaliatory tariffs contemplated under various sections of the 1974 Trade Act, there are other and more effective pressure points that could be used. Specifically, the Administration should begin now to:

- **Direct** the U.S. Trade Representative to prepare a formal complaint against China at the WTO,
- **Review** technology export controls and reassess their impact on U.S. defense preparedness, and
- **Rigorously review and enforc**e controls on Chinese technicians seeking to work on advanced scientific and technological projects in the United States.

Some believe that the threat of punitive tariffs on Chinese goods (for instance, under Section 301 of the Trade Act) has been an effective lever on Chinese behavior in the past, and this is a view generally

- With the Chinese market for imported soybeans valued at $2 billion annually, Beijing's temporizing cost U.S. farmers at least $112 million in 2002.
- Beijing wants to force foreign firms to set up billion-dollar semiconductor "fabs" inside China to support its defense technology sector.
- "[D]espite China's commitments to cracking down on rampant piracy, fake CDs, DVDs and pharmaceuticals continue to flood the market, costing us [an] estimated $20-25 billion annually."
- U.S. companies acknowledge that their Chinese joint venture partners and the Chinese government siphon off proprietary technology, trade secrets, and intellectual property, but they are reluctant to pursue the issue for fear that it will affect their business standing in China.
- The apparent undervaluation of China's currency appears to be an outgrowth of China's insistence on restricting the outflow of capital, but destabilizing China's currency would not reduce America's problems.

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shared by congressional experts.[1] Nonetheless, across-the-board tariffs on Chinese goods would significantly raise prices for U.S. consumers. Therefore, their macroeconomic impact needs to be considered very carefully before any serious thought is given to their implementation.[2]

China's WTO Commitments

Although China has been a member of the WTO for over 18 months, it still retains significant trade barriers in violation of its WTO accession commitments.[3] U.S. manufacturers complain of substantial trade barriers to U.S. agricultural exporters, rampant piracy of intellectual property, forced technology transfer from firms launching joint ventures in China, and capital markets that are largely insulated from free market pressures.

The Administration is aware of these issues and has promised to address them. Nevertheless, they have been a regular feature of U.S. trade with China for decades—so far with little substantive reaction from the United States.

Barriers to Imports of U.S. Farm Products

China's dilatory implementation of its WTO commitments to regulatory transparency continues to impede market access for many U.S. agricultural products, particularly soybeans, wheat, corn, cotton, vegetable oils, poultry, and pork. While U.S. officials attribute some of these problems to "unfamiliarity with the relevant WTO agreements or the requirements of specific commitments made by China," it is increasingly clear that government-encouraged protectionism is driving most of China's misbehavior.[4] The Chinese government's treatment of soybean imports is the most glaring example.

Almost immediately after joining the WTO in January 2002, China issued new regulations on soybeans that require U.S. shippers to get safety certificates before unloading gene-altered crops and food ingredients at Chinese ports of entry. The Chinese had agreed to modify their regulations in June 2002,[5] but not before U.S. soybean exporters had lost at least $112 million in sales that year alone. Although the Chinese government has granted "temporary" extensions of "safety certificates" to April 2004, the regulations are substantially unchanged and cast a pall of uncertainty over future soybean sales that continues to affect pricing contracts—with the apparent purpose of benefiting less efficient Chinese soybean farms at foreign expense.

In a separate controversy in June 2003, the chief U.S. agriculture trade negotiator charged that China continued to block imports of American soybeans, corn, and other crops for nonscientific phytosanitary reasons. He also complained that lack of transparency and other problems in China's plant inspection system make it difficult to import U.S. farm goods into China.[6]

U.S. complaints about the lack of "transparency" seemed to be validated by a senior Chinese official who blamed Chinese importers for violating PRC government rules by signing contracts before applying for an import permit: "The main reason for the problem in the license granting is these [importers] don't have a clear understanding of the approval procedures."[7] The complexity of the procedures—no doubt intentional—makes this entirely understandable.

In August, Chinese officials informed U.S. soybean exporters that U.S. soy imports would be ter-

1. See Wayne M. Morrison, "China–U.S. Trade Issues," Congressional Research Service Issue Brief for Congress No. IB91121, updated August 4, 2003, pp. C12–C14.
2. For a discussion of the economic impact of tariffs, see Marc A. Miles and Ana Isabel Eiras, "Undervaluing the Damage of a Tariff," Heritage Foundation *Executive Memorandum* No. 902, October 3, 2003.
3. For the full text, see World Trade Organization, *Report of the Working Party on the Accession of China*, November 10, 2001, at *www.wto.org/english/thewto_e/acc_e/wp_acc_chinaadd1_e.doc*.
4. See Office of the U.S. Trade Representative, *2002 Report to Congress on China's WTO Compliance*, p. 28, at *www.ustr.gov/regions/china-hk-mongolia-taiwan/2002-12-11-China_WTO_compliance_report.PDF.*
5. See Ann M. Veneman, U.S. Secretary of Agriculture, "Transcript: U.S. Seeks to Help China Implement WTO Commitments," July 29, 2003.
6. Associated Press, "US Trade Official: China Violating WTO," June 12, 2003.
7. Associated Press, "China Denies Blocking U.S. Soybeans," June 26, 2003.

minated because the shipments had been infected with phytophtera, a fungal disease that is endemic to China, but poses no additional risk to Chinese crops. Although the notification was never put in writing, several large orders were cancelled. U.S. Department of Agriculture officials say China's action is mainly a protectionist attempt to support Chinese farmers at the start of the domestic soybean harvest by blocking the import of high-quality, cheaper U.S. beans.[8]

In general, the Chinese show no movement toward easing their bans on American farm products. On August 25, 2003, Secretary of Agriculture Ann Veneman said that China is causing "unwarranted disruptions" in U.S. soybean exports to China for non–science-based phytosanitary reasons.[9] With the Chinese market for imported soybeans valued at $2 billion annually, Beijing's temporizing cost U.S. farmers at least $112 million in 2002, and the uncertainty in the market may be depriving U.S. farmers of hundreds of millions in additional soybean sales in China this year.[10]

China offers American agriculture huge opportunities, but China's illicit restrictions must be addressed immediately if American farmers are to gain the market access that the Chinese promised and the WTO mandates.

China's Semiconductor Rebates

In June 2003, the World Semiconductor Council and the U.S. Semiconductor Industry Association (SIA) formally complained that China levies a 17 percent "value added tax" on all semiconductor and integrated circuits products, but offers a rebate for domestic products. Under this new post-WTO tax regime, China taxes foreign-designed integrated circuits manufactured within China at 6 percent while integrated circuit designs developed in the country are taxed at only 3 percent.[11]

The purpose of this tax is transparent. China seeks to force the world's most advanced semiconductor manufacturers to invest billions of dollars in China—both in chip manufacturing and chip design. Without the tax, it would make no economic sense for foreign firms to set up semiconductor "fabs" (design houses) in China because these are highly capital-intensive ventures that would take little advantage of China's low wage structure.

Integrated circuit (IC) components are high-value, low-weight, durable, and very transportable. They can be air-shipped quickly to customers across the globe from a central fabrication plant. Taiwan built up its semiconductor waferfab infrastructure over the past two decades using this exact model. Indeed, upon receiving the "tape-out" blueprints of a chip design from a customer, Taiwan's (or South Korea's or Singapore's) fabs can turn out thousands of customized IC chips in a matter of days and airship them to the consumer anywhere in the world.

China's rapidly expanding semiconductor demand is well suited to this business model because manufacturers in China have easy and quick access to foreign-built semiconductors flown in from overseas. China's central government, however, is not satisfied with this. According to a report

8. Peter Wonacott and Phelim Kyne, "In Shift, U.S. Investors Intensify Criticism of China Trade Policies: U.S. and European Groups Say Nation Is Backpedaling on Commitments to Body," *The Wall Street Journal*, October 6, 2003, p. A01, at *online.wsj.com/article/0,,SB106538025517840800,00.html*.

9. U.S. Department of State, International Information Programs, "Veneman Says Blockage of U.S. Soybeans 'Unwarranted,'" press briefing, August 26, 2003, at *usinfo.state.gov/xarchives/display.html?p=washfile-english&y=2003&m=August&x=20030826143622emmoccmk0.3878748&t=usinfo/wf-latest.html*.

10. Figures published by the U.S. International Trade Commission show that U.S. soybean exports to China in 2002 dropped by $112 million from just over $1 billion in 2001. The American Soybean Association reports that China has imported over $1.7 billion in U.S. soybeans for the first eight months of 2003. See American Soybean Association, *Weekly Update*, September 1, 2003, at *www.asasoya.org/News/Weekly/Soy090103.htm*. See also Wayne M. Morrison, "China–U.S. Trade Issues," Congressional Research Service *Issue Brief*, updated May 16, 2003, p. 8.

11. See "National Treatment for All Products," *Joint Statement on the Seventh Meeting of World Semiconductor Council (WSC)*, Nice, France, May 15, 2003, statement 3a, at *www.semiconductorcouncil.org/news/wsc_meet_7.html*. For a short summary of the issue, see Associated Press, "China Is Accused of Violating Free Trade Pact with Rebates," *Taipei Times*, June 7, 2003, p. 12, at *www.taipeitimes.com/News/worldbiz/archives/2003/06/07/2003054331*.

from the U.S. General Accounting Office, Beijing wants to force foreign firms to set up billion-dollar fabs inside China to support its defense technology sector.

At present, Motorola and NEC have waferfab operations in China, but they are supervised by non-Chinese operators. This enables those production lines to obtain export-license access to American-made semiconductor manufacturing equipment that would be denied to Chinese government-owned firms, especially firms owned by the defense industry.

In order to gain access to advanced technology for its military, China is now pressuring foreign firms to allow increasing levels of Chinese government oversight of domestic semiconductor operations. In some cases, the Chinese government has apparently set up "false foreign devil" waferfabs—ostensibly under Taiwanese direction but owned by the Chinese government—and is outfitting them with state-of-the-art imported chip-making machinery.

There can be no doubt that China is using illicit "value added taxes" and "rebates" to discourage the import of finished IC chips in order to build up a domestic semiconductor industry for which there is no economic need.[12]

The U.S. Trade Representative should bring immediate action against China in the WTO, demanding the elimination of the discriminatory tax and rebate structures and requiring full compensation of exporters whose products have been taxed at the higher rate. The U.S. Departments of Commerce and Defense must re-examine U.S. export control policies and coordinate with friends and allies to ensure that advanced defense-critical technologies are not being released to IC production lines in China.[13] Congress also has a role in ensuring that China's discriminatory policies designed to force American high-tech firms to invest in China's semiconductor and advanced-technology sectors do not compromise U.S. national security.[14]

Piracy of Intellectual Property

The U.S. Trade Representative reports that "[e]ffective enforcement against [intellectual property rights] infringement in China is universally recognized as the chief concern of rights-holders, as piracy rates in China in all areas, including copyright, trademark and patents, continues to be excessively high."[15] He further notes that inadequate enforcement "has resulted in piracy levels in China for most copyright sectors at around or in excess of 90 percent."[16] One senior U.S. official estimates that "despite China's commitments to cracking down on rampant piracy, fake CDs, DVDs and pharmaceuticals continue to flood the market, costing us [an] estimated $20–25 billion annually."[17]

Secretary of Commerce Donald Evans recently cited one example of how China's lax enforcement of intellectual property rights affects American exporters. Evans explained that Wrigley's chewing gum brands have a 70 percent share in China, but that Chinese counterfeiters pirate Wrigley products, distribute them in counterfeit Wrigley trucks, drive Wrigley's distribution routes, and pay "premiums" to

12. This is an unsettling phenomenon because the whole idea of a highly capital-intensive (i.e., in the billion-dollar range) "foundry" waferfab is that it does not need to be near the customer. Indeed, downstream consumers of foundry products are widespread and located in various national jurisdictions. Moreover, because the output unit products of a foundry fab are small, lightweight, and high-value, they are easily and cheaply transportable. In fact, most American semiconductor producers subcontract some or all of their integrated circuit designs to foundry fabs in Taiwan or elsewhere and airship them back to the United States or onward to foreign end users. Therefore, there is little, if any, utility to investing a billion dollars in an advanced foundry waferfab in China so the fab can be in close proximity to some customers when imported semiconductors can be available to any end-user production line in China within a matter days for a microscopic fraction of the cost.

13. See U.S. General Accounting Office, *Export Controls: Rapid Advances in China's Semiconductor Industry Underscore Need for Fundamental U.S. Policy Review*, GAO–02–620, April 2002, at *www.gao.gov/new.items/d02620.pdf*.

14. For a discussion of the strategic ramifications of technology flight in the U.S. semiconductor sector, see Charles W. Wessner, *Securing the Future: Regional and National Programs to Support the Semiconductor Industry—Policy Considerations*, report to the National Academies of Science, May 8, 2003.

15. Office of the U.S. Trade Representative, *2002 Report to Congress on China's WTO Compliance*, p. 36.

16. *Ibid.*

shop owners for accepting the counterfeit gum.[18] The lack of Chinese government attention to these crimes indicates official tolerance for this behavior.

But the Chinese government's disinterest in the theft of chewing-gum brands is the least worrisome aspect of China's lax-to-nonexistent enforcement of intellectual property laws. The forced transfer of technology from firms launching joint ventures to their Chinese partners is a staple of China's industrial policy. The most egregious example is the 17 percent value-added tax on foreign-manufactured semiconductors.[19] Furthermore, in some cases, as those factories prove uneconomical, Chinese interests buy them up at hefty discounts.[20]

Theft of Advanced Technology

China's official, government-sanctioned theft of advanced-technology intellectual property is another regular feature of China's industrial policy. In late 2002, for example, Chinese engineers attempted to steal software and hardware secrets from Sun Microsystems, NEC Electronics Corporation, and Transmeta Corporation offices in California's Silicon Valley.[21]

A year earlier, an agent apparently supported by the Chinese government stole industrial secrets from Lucent Technology and others. Among the files of the arrested Chinese engineers, FBI investigators discovered correspondence with the "National High-Technology Research and Development Program of China," which revealed that a Chinese government "panel of experts" had determined that the engineers' activities in the U.S. would have "a positive effect on development of China's integrated-circuit industry" and had recommended that "every government department implement and provide energetic support."[22]

In January 2001, U.S.-based Cisco Systems discovered that China's government-controlled (if not state-owned) Huawei Technologies had illegally copied Cisco firmware and software for Huawei's routers. Huawei had pirated vast swathes of Cisco software, with "hundreds of smoking guns" in the over 15 million lines of code, including exact matches with Cisco's software—even Cisco's software bugs, glitches, and misspellings. Moreover, when Huawei could not decode Cisco's source codes, the company attempted to hire Cisco programmers to do it for them.[23] In January 2003, Cisco sued Huawei in U.S. federal court, accusing Huawei of "pervasive and systematic" efforts to "steal and use Cisco's technology," and Huawei withdrew from the U.S. market.[24]

The Cisco case is only the tip of the iceberg. Other U.S. companies acknowledge that their Chinese joint venture partners and the Chinese govern-

17. See Henry A. Levine, Deputy Assistant Secretary of Commerce, "Is China Playing by the Rules? Free Trade, Fair Trade, and WTO Compliance," statement to the Congressional–Executive Commission on China, September 24, 2003, at *hongkong.usconsulate.gov/uscn/trade/general/doc/2003/092501.htm*. Estimating the amount of revenue lost because of piracy is an inexact science. The $20 billion–$25 billion number is based on industry estimates of the full retail value for all illegal products sold in China each year, and it is useful in pegging the magnitude of the problem. Although not everyone who bought an illegal product would have bought a legal version if given no other choice, revenue lost due to piracy in China is in the billions of dollars, even by the most conservative estimates.

18. Clare Ansberry and Tom Hamburger, "Bush Is Forming Team to Battle Unfair Trade, Commerce Department Unit to Investigate Complaints of Dumping and Subsidies," *The Wall Street Journal*, September 15, 2003, p. 1, at *online.wsj.com/article/0,,SB106357787825172900,00.html*.

19. For an expanded discussion of this issue, see John J. Tkacik, Jr., "China's Chip Cheating Needs Swift U.S. Response," Heritage Foundation *Web Memo* No. 278, May 20, 2003, at *www.heritage.org/Research/AsiaandthePacific/wm278.cfm*.

20. Richard McGregor and Ien Cheng, "SMIC Close to Motorola Plant Deal," *Financial Times*, September 11, 2003, at *news.ft.com/s01/servlet/ContentServer?pagename=FT.com/StoryFT/FullStory&c=StoryFT&cid=1059479756307&p=1012571727313*.

21. John R. Wilke, "U.S. Agents Try to Tie Alleged Tech Thefts to Companies Run by Chinese Government," *The Wall Street Journal*, January 15, 2003, at *online.wsj.com/article/0,,SB1042580870500857584,00.html*.

22. Associated Press, "Prosecutors in Lucent Theft Case Say More Companies Were Victims," *The Wall Street Journal*, April 12, 2002, at *online.wsj.com/article/0,,SB1018620030585182000,00.html*.

23. Scott Thurm, "Court Papers Show Huawei Tried to Hire Cisco Engineers," *The Wall Street Journal*, March 17, 2003, at *online.wsj.com/article/0,,SB1047880038863522000,00.html*.

ment siphon off proprietary technology, trade secrets, and intellectual property, but they are reluctant to pursue the issue for fear that it will negatively affect their business standing in China. Apparently, the Chinese government's preferred way of gaining access to U.S. advanced technology is via human sources, particularly students and technicians from U.S.–Chinese joint ventures in China who want to work in advanced-technology laboratories and production facilities in the United States.[25]

Nor are American high-tech firms China's only victims. In March 2002, Taiwan Semiconductor Manufacturing Company (TSMC) accused a former manager of stealing information on its 12-inch wafer fabrication technology.[26] Later, TSMC discovered that documentation for its entire eight-inch waferfab production line had been posted on-line without authorization with Taiwan's National Chiao-tung University library and that another employee had downloaded and copied it.[27]

In March 2003, in a comprehensive report on China's WTO compliance, Japan's Ministry of Economy, Trade and Industry (METI) commented that "intellectual property rights infringements, including counterfeiting and piracy, have long been a serious problem in China" and observed that the Beijing government has "taken steps to deal with the problems, but little improvement has been seen." The METI report pointed to China's immature domestic legal structure, lack of transparent and uniform administration, and poor training.[28]

Capital Controls

Another key WTO commitment made by China was to allow foreign banks to conduct foreign currency business with Chinese firms and private individuals immediately upon accession. Within two years of accession, foreign banks were supposed to be able to conduct domestic currency (i.e., renminbi "yuan") transactions with Chinese firms. Within five years, foreign banks should be able to conduct full domestic currency business in China with both firms and private individuals.[29]

Nearly two years after WTO accession, China has yet to permit any foreign banks to compete in China's financial services market. Citibank and the Hong Kong and Shanghai Banking Corporation—the only two foreign banks licensed in China—are doing local currency business consistent with China's geographic phase-ins (i.e., still in select cities), although the types of products they are entitled to offer remain circumscribed.

The Chinese have managed to keep out all other foreign banks by imposing working capital requirements and other prudential rules that are so far in excess of international standards that few foreign banks—and no Chinese banks—can meet them. Moreover, the applications of the banks that have applied to broaden their market presence are languishing in the in-boxes of China's central bank.[30] Foreign insurance service providers are similarly hamstrung by China's impossible regulatory structure—again, in violation of China's WTO commitments.

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24. Scott Thurm, "Cisco Ran Sting Operation to Nab a Copycat in China," *The Wall Street Journal*, April 4, 2003, at *online.wsj.com/article/0,,SB104942212126672500,00.html*.

25. See U.S. General Accounting Office, *Export Controls: Department of Commerce Controls over Transfers of Technology to Foreign Nationals Need Improvement*, GAO–02–972, September 2002.

26. See Jimmy Chuang, "Industrial Espionage Investigation Turns to E-mail Recipient," *Taipei Times*, March 10, 2002, at *www.taipeitimes.com/news/2002/03/10/story/0000127077*, and "Ex TSMC Employee Suspected of Selling Secrets to Shanghai," *Taipei Times*, March 7, 2002, at *www.taipeitimes.com/news/2002/03/07/story/00001266*.

27. See "Company's Secret Theft Claims Leaves TSMC Looking Dumb," *Taipei Times*, March 20, 2002, at *www.taipeitimes.com/news/2002/03/20/story/0000128440*.

28. Agence France-Presse, "Japan Urges China to Stamp Out Piracy, Abide by WTO Rules," *Taipei Times*, March 29, 2003, at *www.taipeitimes.com/News/biz/archives/2003/03/29/199937*.

29. Office of the U.S. Trade Representative, *2002 Report to Congress on China's WTO Compliance*, p. 36.

30. *Ibid.*, p. 41. This information is current as of September 2003 according to an e-mail from the U.S. Trade Representative's China office.

The obvious reason for China's resistance to opening its financial markets is that China's banking system is so overloaded with bad debt that state banks cannot compete with privately run foreign banks. China's four largest banks are technically insolvent, with around half of their loan portfolios categorized as nonperforming. The only thing keeping China's banks afloat is their monopoly with China's individual savers, who are among the world's most conservative, with a savings rate of 40 percent.

Nonetheless, China must not be permitted to persist in flouting its WTO obligations—without which it would not have been permitted WTO membership.[31]

Is the Chinese Currency Undervalued?

While many of China's illicit trade barriers have resulted in significant losses and potential losses to U.S. exporters, the debate in the United States has focused obsessively on the "undervaluation" of China's currency. In fact, China's yuan has been pegged to the U.S. dollar for nearly a decade at 8.28 yuan to the dollar.

Many American manufacturers are suspicious of the "undervalued" yuan because, in far too many cases, finished Chinese goods can be imported into the United States at prices cheaper than the raw materials costs to the U.S. manufacturer of identical products. In most cases, however, the high cost of basic raw materials to U.S. manufacturers can probably be traced to the high capital investment costs to domestic raw materials producers.

The additional environmental, regulatory, community compliance, and energy costs of an aluminum smelter or petrochemical refinery in the United States, for example, are so onerous that not one oil refinery has been built in the United States since 1976 and the last aluminum smelter built in the United States opened in 1980. Moreover, high tax rates on repatriated overseas earnings discourage American companies from reinvesting foreign profits in plant and equipment in the United States.[32]

The apparent undervaluation of China's currency appears to be an outgrowth of China's insistence on restricting the outflow of capital, and the "undervalued" yuan is a misguided concern. Destabilizing China's currency would not reduce America's problems. As Japan learned in the 1980s, revaluing its currency upward actually increased its trade surplus with the United States. After all, as *The Wall Street Journal* puts it, "currency rates affect trade flows very little once companies and economies adjust."[33]

China's overall trade surplus is less than 6 percent of its total trade—on the order of $30 billion out of $600 billion. China's ballooning foreign exchange reserves (near $350 billion) have little to do with the trade value of the currency.[34] Instead, China's reserves are growing because of foreign direct investment that totals $40 billion–$50 billion per year, while outflows are restricted. Encouraging China to revalue its currency upwards would not solve that problem, and one estimate indicates it would result in no more than $10 billion in additional U.S. exports to China—and then only after a "period of time"—and that a floating yuan might just as easily result in its depreciation.[35]

31. For an expanded discussion, see "Banking on Growth," *The Economist*, January 16, 2003.
32. For an extended discussion, see Daniel J. Mitchell, Ph.D., "Making American Companies More Competitive," Heritage Foundation *Backgrounder* No. 1691, September 25, 2003, at *www.heritage.org/Research/Taxes/BG1691.cfm*.
33. See "Snow's Currency Job," *The Wall Street Journal*, September 23, 2003, p. A20, at *online.wsj.com/article/0,,SB106427854556020500,00.html*. For an academic study of the exchange rate issue, see Marc A. Miles, "The IMF's Destructive Focus on Devaluation," paper presented at Cato Institute conference on "Multilateral Aid: Fostering Independence or Addiction," Washington, D.C., May 8, 1991.
34. See Bank for International Settlements, *BIS Quarterly Review, International Banking and Financial Market Developments*, June 2003, pp. 50–53.
35. Dr. Nicholas Lardy, testimony before Committee on Foreign Relations, U.S. Senate, September 11, 2003, in verbatim transcript, "U.S. Senator Richard G. Lugar (R–IN) Holds Hearing on Relations with China," prepared by Federal Document Clearing House.

In theory, China's restraints on outward capital movements will be relieved as China opens up its financial services markets as required under the terms of its WTO accession. All of China's trading partners should insist that China abide by its WTO obligations and ease its capital controls sooner rather than later.

What the Administration and Congress Should Do

The Administration should not simply ignore China's trade misbehavior or trust that the interests of America's exporters will be protected by the often years-long process of presenting a case to the World Trade Organization. Certainly, China's unfair trade practices must be challenged in the WTO, but the Administration should begin to apply other pressures.

Specifically, the Administration should:

- **Direct** the U.S. Trade Representative to prepare a formal complaint against China at the WTO,
- **Review** technology export controls and reassess their impact on U.S. defense preparedness, and
- **Rigorously review and enforce** controls on Chinese technicians seeking to work on advanced scientific and technological projects in the United States.

As noted, some observers believe that the threat of punitive tariffs on Chinese goods has been an effective lever on Chinese behavior in the past. If one accepts that view, it might be argued that the prospect of such action could get China's attention and yield results in the current situation. Nevertheless, across-the-board tariffs on Chinese goods could significantly raise prices for U.S. consumers. Therefore, their macroeconomic impact should be considered very carefully before any serious thought is given to their implementation.

Conclusion

China is in serious violation of its trade commitments to the United States as well as its other trading partners. However, in other areas, such as the migration of advanced technology to China—licitly and illicitly—the United States must tend to its own house. There is room for improvement in the enforcement of national security technology transfer regimes, tightening export controls, and guarding against industrial espionage.

Clearly, Beijing must be made to feel the consequences of its illegal trade practices. A coordinated effort by the Administration and Congress to protect strategic industries, including down-stream defense-critical manufacturing infrastructure, would effectively signal that America will no longer tolerate China's behavior.

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