

# THE CHINESE AUTOMOBILE INDUSTRY AND THE WORLD TRADE ORGANIZATION: CHINA'S NON-COMPLIANCE WITH WTO REGULATIONS THROUGH ITS SUBSIDIZING OF AUTOMOBILE MANUFACTURERS

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## INTRODUCTION

Since its accession to the World Trade Organization (WTO)<sup>1</sup> in 2001,<sup>2</sup> China has been the subject of much scrutiny in terms of its compliance with WTO policies and regulations.<sup>3</sup> While government agencies in the United States generally agree that China has made significant progress toward implementing its WTO commitments, there are several aspects of China's commitments that it has yet to fulfill.<sup>4</sup> One such insufficiency is that China still maintains policies of differential tax treatment toward its domestic industries, favoring domestic production and discriminating against imports.<sup>5</sup> The objectionable effect of these practices is that China is able to enjoy the advantages of trading in an international forum while restricting access to its own market by foreign competitors.<sup>6</sup>

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1. The WTO is an organization designed to facilitate, promote, and protect free international trade; it currently has 151 Member states. World Trade Organization, [http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/fact1\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact1_e.htm) (last visited Feb. 23, 2009).

2. World Trade Organization, Ministerial Decision of 10 November 2001: Accession of the People's Republic of China, WT/L/432 (2001) [hereinafter Accession of China].

3. SUSAN KRAUSE, U.S. DEP'T OF STATE, CHINA'S INDUSTRIAL POLICIES CONFLICT WITH WTO RULES, EXPERTS SAY: SUBSIDIES, TAX BREAKS, PRODUCT STANDARDS CREATE DISCRIMINATORY CLIMATE (2005) available at <http://usinfo.state.gov/eap/Archive/2005/Jun/02-648829.html> [hereinafter KRAUSE, CHINA'S INDUSTRIAL POLICIES CONFLICT WITH WTO RULES].

4. THE U.S.-CHINA BUSINESS COUNCIL, CHINA'S IMPLEMENTATION OF ITS WORLD TRADE ORGANIZATION COMMITMENTS: AN ASSESSMENT BY THE U.S.-CHINA BUSINESS COUNCIL 3 (2007) available at <http://www.uschina.org/public/documents/2007/09/usc-bc-china-wto-implementation-testimony.pdf> [hereinafter U.S.-CHINA BUSINESS COUNCIL]. See also SUSAN KRAUSE, U.S. DEP'T OF STATE, ANNUAL REPORT ON CHINA WTO COMPLIANCE SHOWS MIXED RESULTS, 2005, available at <http://usinfo.state.gov/eap/Archive/2005/Dec/15-959311.html> [hereinafter KRAUSE, ANNUAL REPORT ON CHINA WTO COMPLIANCE].

5. U.S.-CHINA BUSINESS COUNCIL, *supra* note 4.

6. *See id.*

As China is a rapidly rising force in the world economy, it is apparent why China would take steps toward full compliance with the WTO in some respects and yet still provide excessive tax relief or other incentives for industries in which China wants to drastically improve its international competitiveness.<sup>7</sup> The goal of this policy appears to be twofold. First, it allows China to point to its ostensible progress in becoming fully compliant with the WTO so that it can further its integration into the world economy with WTO approval.<sup>8</sup> Second, maintaining domestically favorable tax and subsidy policies enables China to accelerate growth and production of its own manufacturers, boost exports, and thus gradually overtake a significant market share in industries in which China has traditionally been a major importer.<sup>9</sup> However, as long as China continues to implement differential tax incentives and subsidies, the United States and other WTO Member states will have an enormous comparative disadvantage in such subsidized industries.<sup>10</sup> For example, if China should subsidize its steel manufacturers contingent upon exports per year and simultaneously increases tariffs on steel imports, then China would be able to sell steel around the world at low prices with which international competitors would likely be unable to compete.<sup>11</sup> This and other unfair trade practices are precisely what the WTO seeks to prevent,<sup>12</sup> and they are precisely what China agreed to discontinue when it acceded to the WTO in 2001 and became bound by the Agreement on Subsidies and Countervailing Measures.<sup>13</sup>

One industry in which China has historically been a major importer, and has only recently become a global economic force in itself, is the automobile industry.<sup>14</sup> China's increase in net production since 2000 has positioned it far in advance of other potential major automobile producers such as Brazil and

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7. See NICHOLAS R. LARDY, ISSUES IN CHINA'S WTO ACCESSION 1 (2001), available at [http://www.brookings.edu/testimony/2001/0509foreignpolicy\\_lardy.aspx](http://www.brookings.edu/testimony/2001/0509foreignpolicy_lardy.aspx).

8. See KRAUSE, CHINA'S INDUSTRIAL POLICIES CONFLICT WITH WTO RULES, *supra* note 3, at 1.

9. *Id.*

10. KRAUSE, ANNUAL REPORT ON CHINA WTO COMPLIANCE, *supra* note 4, at 3.

11. See KRAUSE, CHINA'S INDUSTRIAL POLICIES CONFLICT WITH WTO RULES, *supra* note 3, at 1.

12. See Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, Multilateral Agreements on Trade in Goods – Results of the Uruguay Round (1994) [hereinafter Agreement on Subsidies and Countervailing Measures].

13. *Id.* at art. IV. See also Committee on Subsidies and Countervailing Measures, *Notification of Laws and Regulations Under Article 32.6 of the Agreement – People's Republic of China*, WT/G/SCM/N/1/CHN/1/Suppl.3 at ch. 2 (Oct. 20, 2004).

14. In the third quarter of 2005, Chinese automobile exported units exceeded imported units for the first time ever, with exports hitting 135,000 units and imports at 128,000 units. However, it should be noted that the *value* of the imports still exceeded that of exports. *Chinese Car Exports Top Imports: Chinese Car Exports Are Exceeding Imports for the First Time, Figures Show, But Officials Have Warned of Possible Over-Production in the Sector*, B.B.C. NEWS, Dec. 6, 2005, at 1, available at <http://news.bbc.co.uk/2/hi/business/4502098>.

Thailand, and it has launched China to third place in world leaders for auto production, surpassing Korea and Germany and trailing only Japan and the United States.<sup>15</sup> Not only has China's auto production rapidly escalated in the past decade, but the compact cars it is producing are very inexpensive.<sup>16</sup> This may have a devastating effect on the United States automobile industry, as major U.S. manufacturers almost certainly could not compete with Chinese manufacturers' low prices.<sup>17</sup> Such price disparity has also aroused suspicions of unfair subsidization practices in China.<sup>18</sup> One way a company can produce products at or below the cost of raw materials without losing money is through receipt of government subsidies.<sup>19</sup> In addition to mere suspicions, the Chinese government has actually engaged in several questionable subsidization practices to promote its own industry.<sup>20</sup> These include: 1) establishing export quotas in 2007 to determine the amount of state funding for its manufacturers, and 2) requiring high levels of domestic content for joint ventures – from requiring forty percent local content at the outset to requiring eighty percent by the third year.<sup>21</sup> These policies aim to enhance Chinese export volume and promote domestic over imported goods.<sup>22</sup> They are also illegal according to the WTO.<sup>23</sup>

All major players in the automotive industry have serious economic interests in Chinese compliance with the WTO.<sup>24</sup> The United States, however, has an especially large stake in demanding Chinese compliance in its production of automobiles: as China prepares to introduce its automobiles in the U.S. market in the near future,<sup>25</sup> it becomes crucial to U.S. competitiveness

15. STEPHEN COONEY, CRS REPORT FOR CONGRESS: CHINA'S IMPACT ON THE U.S. AUTOMOTIVE INDUSTRY, at 3 (2006), available at <http://www.fas.org/sgp/crs/misc/RL33317.pdf>.

16. Some Chinese cars have been priced at \$4,000. *Cheap Chinese Cars Rattle Industry Giants' Nerves*, THE FIN. EXPRESS, Sept. 14, 2005, at 1, available at [http://www.financialexpress.com/old/fe\\_full\\_story.php?content\\_id=102548](http://www.financialexpress.com/old/fe_full_story.php?content_id=102548).

17. David Kiley, *Is America Ready for Cheap Chinese Cars? Chinese-Made Autos Are Coming to the U.S., But Recent Quality Concerns Could Make Buyers Choose Safe Cars Over Cheap Ones*, BUS. WK., July 9, 2007, at 1, available at [http://www.businessweek.com/autos/content/jul2007/bw2007076\\_421598.htm](http://www.businessweek.com/autos/content/jul2007/bw2007076_421598.htm). See also Franklin J. Vargo, Vice President of International Economic Affairs, National Association of Manufacturers, Testimony Before the Subcommittee on Trade of the House Committee on Ways and Means 1, 4 (Feb. 15, 2007), available at <http://waysandmeans.house.gov/hearings.asp?formmode=printfriendly&id=5461> [hereinafter Vargo, Testimony Before the Subcommittee on Trade].

18. Vargo, Testimony Before the Subcommittee on Trade, *supra* note 17, at 1.

19. *Id.* at 2.

20. Irina Aervitz, *Chinese Cherish Their Chery*, ASIA TIMES ONLINE, May 25, 2007, at 2 available at [http://www.atimes.com/atimes/China\\_Business/IE25Cb01.html](http://www.atimes.com/atimes/China_Business/IE25Cb01.html). See also Vargo, Testimony Before the Subcommittee on Trade, *supra* note 17, at 1.

21. Aervitz, *supra* note 20, at 2.

22. *Id.* See also Vargo, Testimony Before the Subcommittee on Trade, *supra* note 17, at 2; KRAUSE, CHINA'S INDUSTRIAL POLICIES CONFLICT WITH WTO RULES, *supra* note 3, at 1.

23. See Agreement on Subsidies and Countervailing Measures, *supra* note 12, at Part II.

24. Kiley, *supra* note 17, at 1. See also, e.g. Greg Keenan, *Chinese Cars Headed for Canada at Cut-Rate Prices*, REPORTONBUSINESS.COM, Jan. 16, 2008, available at <http://www.reportonbusiness.com/servlet/story/RTGAM.20080114.wrchina14/BNStory/Business/home>.

25. Kiley, *supra* note 17, at 1.

that China engages in fair trading practices.

There are three major purposes of this Note. First, this Note aims to determine the extent to which major Chinese automobile manufacturers are subsidized by the Chinese government, as relative to the extent to which other global industry leaders are subsidized by their respective governments, including Korea, Germany, Japan, and the United States.<sup>26</sup> It should be noted that obtaining precise and accurate subsidy figures for each of the manufacturers scrutinized in this Note is an expensive procedure that could take years to accomplish, even for sophisticated government agencies or the WTO itself.<sup>27</sup> Such a task is beyond the scope of this Note. Instead, this Note will utilize the public financial information of each of the manufacturers, allegations of WTO violations, and other sources of evidence to develop estimates of the relative degrees of subsidization employed by each of the countries surveyed herein.<sup>28</sup>

Second, having established relative degrees of subsidization, this Note will analyze whether and how these subsidies are illegal according to the WTO Agreement on Subsidies and Countervailing Measures.<sup>29</sup> This Note will discuss the countervailing measures available to other Member states of the WTO against those states found to be illegally subsidizing their auto manufacturers.

Third, this Note will analyze the macroeconomic effects of noncompliance with the WTO through use of prohibited subsidies, and it will contemplate how full compliance would affect international automotive trade.<sup>30</sup> This analysis will also discuss the practical reasons for illegalizing certain types of subsidies. It will examine the actual weight of WTO authority along with the effectiveness of the WTO's current remedies for violations.

Part I of this Note will provide background information as to the history of the Chinese automobile industry. It will shed light on China's rise in economic status as an automotive power and will lead into an introduction of the biggest Chinese manufacturers in the industry: First Automotive Works, Shanghai Automotive Industry Corporation, and Dongfeng Motor Corporation.<sup>31</sup>

Part II of this Note will discuss Chinese accession to the WTO and the

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26. See *infra* Part III.

27. "Sometimes it takes years for WTO experts to attest that subsidization actually took place." Aervitz, *supra* note 20, at 3.

28. See *infra* Part III.

29. See *infra* Parts II-III. Subsidies are not facially unacceptable according to the WTO; only subsidies that fall under the "prohibited" category, such as export contingent subsidies and subsidies contingent upon purchase of imports over exports, are deemed illegal. Agreement on Subsidies and Countervailing Measures, *supra* note 12, at Part II.

30. See *infra* Parts III-IV.

31. EAST MIDLANDS-CHINA BUSINESS BUREAU, CHINA: AUTOMOTIVE OVERVIEW, (Nov. 2001), available at <http://www.eastmids-china.co.uk/chinasectorreportautomotiverevie.html> [hereinafter EAST MIDLANDS].

legal implications of China's agreement to be bound by WTO regulations. It will introduce the Agreement on Subsidies and Countervailing Measures, and explain the various types of legal and illegal subsidies.

Part III will report approximate amounts of subsidies received by the top three auto manufacturers in China, as compared to subsidization of a top manufacturer in each of the other industry-leading countries: Korea, Germany, Japan, and the United States. An analysis of the legality of these subsidies and their macroeconomic effects on the global automobile industry will then invite discussion of currently available remedies for the adverse effects of non-compliance.

Part IV of this Note will provide a reassessment of the effectiveness of the remedies and will also weigh the relative authority of the WTO. This section will also demonstrate the importance of a system of international trade that calls for transparency and accountability, focusing on trade practices in the global automobile industry.

Part V will conclude by revisiting the rationale for the very existence of the WTO: fair international trade. The results and analysis of parts III and IV will provide grounds for recommendations to help ensure global fair trade. These include altering and increasing the severity of the consequences of noncompliance with the WTO, and also allowing unilateral action by a country injured through another's WTO violations so that it may close its own markets to the violator until full compliance is manifest.<sup>32</sup> Finally, the accounting system of each Member state of the WTO should be required to meet a WTO-approved set of accounting principles, thus demanding the same degree of transparency from every Member state.<sup>33</sup> This would improve the accountability of all Member states while allowing them to keep, though perhaps reform, their own systems, without attempting to implement a uniform WTO accounting system.<sup>34</sup> These measures would collectively increase the effectiveness of the WTO, promote fairer trade in the auto industry, and protect the United States from unfair competition with Chinese auto manufacturers in the very near future.<sup>35</sup>

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32. See *infra* Part V.

33. See *infra* Part V. See also Vargo, Testimony Before the Subcommittee on Trade, *supra* note 17, at 1-3.

34. See *infra* Part V.

35. See *infra* Part V.

PART I: A BRIEF HISTORY OF THE CHINESE AUTOMOBILE INDUSTRY,  
ITS ESCALATION INTO THE GLOBAL MARKET, AND THE CHINESE "BIG  
THREE"

A. *The Chinese Automobile Industry, Pre-1965*

For the first three decades of the twentieth century, automobiles in China were extremely sparse.<sup>36</sup> Author Eric Harwit discusses three main reasons for such slow growth in the automobile industry during this period in his book, *China's Automobile Industry: Policies, Problems, and Prospects*.<sup>37</sup> First, there were a minimal number of miles of paved roadways throughout the country; for example, in 1937 there were approximately 25,000 miles of paved roadway in China, whereas there were 1.3 million miles of paved roadway in the United States by 1935.<sup>38</sup> Second, the low standard of living meant that, for many workers, it was virtually impossible to afford an automobile, nor did it make sense to purchase one when rickshaws and horse carts were much more efficient means of transportation.<sup>39</sup> Third, the political climate deterred potential buyers: as civil wars broke out and continued during the 1920's, automobiles were often confiscated by feuding warlords.<sup>40</sup> During the 1930's to mid-1940's, a few small-scale Chinese manufacturers began producing small numbers of automobiles, mainly manufacturing trucks.<sup>41</sup>

Although production was minimal during World War II, the newly founded People's Republic of China set an initiative almost immediately to develop a domestic automobile industry.<sup>42</sup> Soon after, with the assistance of the former Soviet Union, China opened its first automobile manufacturer on July 13, 1956, known as First Automotive Works.<sup>43</sup> This production facility originally produced only one model of medium-sized truck and later began manufacturing compact automobiles.<sup>44</sup> In 1958, China's leader Mao Zedong launched an idealist plan he termed the "Great Leap Forward," which was an attempt to bolster China's economy primarily through extremely expedient

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36. ERIC HARWIT, *CHINA'S AUTOMOBILE INDUSTRY: POLICIES, PROBLEMS, AND PROSPECTS* 15 (M. E. Sharpe, Inc. 1995).

37. *Id.*

38. *Id.* at 15-16.

39. *Id.* at 16.

40. *Id.* at 16 (citing WILLIAM IRVINE, *AUTOMOTIVE MARKETS IN CHINA, BRITISH MALAYA, AND CHOSEN 10* (Bureau of Foreign and Domestic Commerce 1923)).

41. HARWIT, *supra* note 36, at 15-16. See also *International Auto Manufacturers Eye NE China*, PEOPLE'S DAILY, March 25, 2001, at 1, available at [http://english.peopledaily.com.cn/200103/25/eng20010325\\_65915.html](http://english.peopledaily.com.cn/200103/25/eng20010325_65915.html).

42. HARWIT, *supra* note 36, at 17.

43. First Automotive Works, History, [http://www.faw.com/webcontent/aboutfaw.jsp?pros=history\\_forward.jsp&phight=550&about=History](http://www.faw.com/webcontent/aboutfaw.jsp?pros=history_forward.jsp&phight=550&about=History) (last visited Feb. 23, 2009).

44. *Id.*

modernization of industry and agriculture, and which was a move toward self-sufficiency in the auto industry.<sup>45</sup> The excessive spending on industrialization, however, caused the effort to collapse in 1961.<sup>46</sup> The effect of the short-lived “Leap” was that the Chinese auto industry again became reliant on Soviet technology.<sup>47</sup> In sum, there was little economic advancement for the industry during the first half of the twentieth century through the mid-1960’s.<sup>48</sup>

### B. *The Chinese Automobile Industry, 1965-Present*

As of 1965, there were approximately twenty automobile manufacturing factories throughout China.<sup>49</sup> While the number of production facilities continued to climb over the next several years, actual production of cars and trucks saw a decline from “55,861 [units] in 1966 to 25,100 in 1968.”<sup>50</sup> Author Eric Harwit suggests this was a result of the Cultural Revolution.<sup>51</sup> Mao Zedong launched the Cultural Revolution in 1966 in order to mobilize urban youths, purge society of old ways of thinking, and make society less elitist.<sup>52</sup> The chaos of the Cultural Revolution led to a twelve percent decrease in general industrial production from 1966 to 1968.<sup>53</sup>

The Chinese auto industry took an upward swing in the early 1970s.<sup>54</sup> In 1971, China engaged the largest Japanese auto manufacturer, Toyota, as a trading partner; from this point, Toyota and the Chinese began to cooperate by exchanging technicians, jointly producing new automobile models, and developing an automotive plant.<sup>55</sup> Domestic production of trucks in China rose from approximately fifty percent in 1970 to sixty-five percent in 1975; the opening up of foreign trade sparked substantial acceleration in the Chinese auto industry.<sup>56</sup>

It was during the early 1980’s that China’s auto production began to spike, doubling from approximately RMB<sup>57</sup> 8.84 billion in 1980 to RMB 16.45

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45. Chris Trueman, *The Great Leap Forward*, HISTORY LEARNING SITE, 1 (2007), [http://www.historylearningsite.co.uk/great\\_leap\\_forward.htm](http://www.historylearningsite.co.uk/great_leap_forward.htm) (last visited Feb. 23, 2009). See also William Harms, *China’s Great Leap Forward*, 15 THE UNIVERSITY OF CHICAGO CHRONICLE 13 (1996) available at <http://chronicle.uchicago.edu/960314/china.shtml>.

46. Harms, *supra* note 45, at 15.

47. HARWIT, *supra* note 36, at 20.

48. *Id.*

49. *Id.* at 24 fig. 2.5.

50. *Id.* at 21 (citing *Zhongguo qiche gongye nianjian* (China Automotive Industry Yearbook) 124 (1991)).

51. HARWIT, *supra* note 36, at 21.

52. Thayer Watkins, *The Great Proletarian Cultural Revolution in China, 1966-1976*, San Jose State University Dep’t of Economics, available at <http://www.sjsu.edu/faculty/watkins/cultrev.htm>.

53. *Id.*

54. HARWIT, *supra* note 36, at 25.

55. *Id.*

56. *Id.*

57. “Chinese currency is called Renminbi (people’s money), often abbreviated as RMB.

billion in 1984, and then doubling again to RMB 37.3 billion by 1988.<sup>58</sup> During this time, the Chinese began to focus more intently on passenger vehicle production, securing an increasing number of joint ventures with foreign manufacturers.<sup>59</sup> For example, in 1983 Beijing Automotive signed the first joint-venture agreement with American Motors Corp. to begin producing Jeeps, and later Shanghai Automotive initiated a joint venture with German manufacturer Volkswagen.<sup>60</sup> With a plethora of small-scale manufacturers having sprouted across China, the government saw a need to consolidate production as a strategy to create a smaller number of large-scale, internationally competitive manufacturers, a policy which is still in place today.<sup>61</sup> China has been successful in restructuring its industry and channeling production, resulting in a handful of present-day automotive giants that continue to rise in the global economy.<sup>62</sup>

C. *The Chinese “Big Three”: First Automotive Works, Dongfeng Motor Group, and Shanghai Automotive Industry Corporation*<sup>63</sup>

While there are approximately 120 auto manufacturers in China, only ten produce over 100,000 units annually.<sup>64</sup> Among these ten are the Chinese “Big Three,” including First Automotive Works (FAW), Shanghai Automotive Industry Corporation (Group) (SAIC), and Dongfeng Motor (Group) Corporation (DFM), ranked first through third respectively.<sup>65</sup> The Chinese government especially supports these three manufacturers through subsidies, loans, and priority in establishing joint ventures with foreign manufacturers in order to draw international investment, fund advanced technology, and attract

It is issued by The Bank of China and is the sole legal tender within the People’s Republic of China. The symbol for RMB is ¥.” Currency Matters, [http://www.travelcentre.com.au/travel/asia/China/chinese\\_currency.htm](http://www.travelcentre.com.au/travel/asia/China/chinese_currency.htm) (last visited Feb. 23, 2009). The symbol ¥ (spelled yuan) will be used to denote Chinese currency throughout the remainder of this Note.

58. HARWIT, *supra* note 36, at 27 (citing China Automotive Technology and Research Center, *Zhongguo de qiche gongye* (Automotive Industry of China) 4 (1989)).

59. *Id.* at 29.

60. Gordon Fairclough & Shai Oster, *Bumpy Ride: As China’s Auto Market Booms, Leaders Clash Over Heavy Toll*, WALL ST. J., June 13, 2006, at 1, available at <http://online.wsj.com/article/SB115016484857578577.htm>.

61. Aervitz, *supra* note 20, at 3. It should be noted that this consolidation policy employs questionable tactics such as providing state support for those manufacturers that meet annual export quotas; this type of export contingent subsidization is prohibited by the WTO. Further discussion of Chinese auto industry consolidation measures follows in Parts III and IV of this note.

62. *Id.* at 2.

63. This section provides a general overview of each of the three major Chinese auto manufacturers, including a brief history, summary of business operations, and assessment of corporate strategy for each. The financial information for each of these companies is likewise crucial, but is not examined until Part III of this Note.

64. EAST MIDLANDS, *supra* note 31.

65. See China Carforums, [http://www.chinacarforums.com/chinese\\_car\\_manufacturers.html](http://www.chinacarforums.com/chinese_car_manufacturers.html) (last visited Feb. 23, 2009).

management expertise.<sup>66</sup>

The third largest Chinese auto manufacturer, DFM, formerly known as Second Automotive Works (SAW), was established in 1969 and has opened multiple major production bases since.<sup>67</sup> These centers are located in Shiyan, Xiangfan, Wuhan, and Guangzhou, and they specialize in the production of medium and heavy duty commercial vehicles, light duty commercial vehicles, and passenger vehicles.<sup>68</sup> Today, DFM production is mainly divided between commercial and passenger vehicles.<sup>69</sup> Contributive to its expansion in the passenger vehicles sector, DFM has engaged in joint ventures with Nissan Motor Co., Ltd.; Honda Motor Co., Ltd.; and Kia Motors Corporation.<sup>70</sup>

A major aspect of DFM's corporate strategy under CEO Xu Ping is Research and Development (R&D).<sup>71</sup> DFM's goals for the next five years include doubling production and sales, strengthening as an internationally competitive manufacturer, and increasing its capability for autonomic development.<sup>72</sup> In furtherance of these goals, Dongfeng Automobile Co., Ltd. announced in October, 2007 that it will be investing ¥ 10 billion through 2010 to develop its DFM brand.<sup>73</sup>

SAIC, the second largest Chinese auto manufacturer, was established in the 1950s and began production in 1958.<sup>74</sup> While SAIC's flagship production center is in Shanghai, it has established bases in Liuzhou, Chongqing, Yantai, Shenyang, Qingdao, and Yizheng, and it also has branches in the United States, Europe, Hong Kong, Japan, and Korea.<sup>75</sup> SAIC engages primarily in the production of passenger vehicles and commercial vehicles, producing 91,000 passenger cars and 42,900 commercial vehicles in 2007.<sup>76</sup> To increase production of passenger cars, SAIC set up a joint venture with Volkswagen, an

66. EAST MIDLANDS, *supra* note 31.

67. *Id.*

68. The Xiangfan center produces passenger vehicles in addition to light duty commercial vehicles, and the Wuhan and Guangzhou centers both principally produce passenger vehicles. Dongfeng Motor Corporation, Corporate Profile, [http://www.dfmc.com.cn/info/introduce\\_en.aspx](http://www.dfmc.com.cn/info/introduce_en.aspx) (last visited Feb. 23, 2009) [hereinafter Dongfeng Motor Corporation, Corporate Profile].

69. China Carforums, [http://www.chinacarforums.com/china\\_auto/dongfeng\\_motor.html](http://www.chinacarforums.com/china_auto/dongfeng_motor.html) (last visited Feb. 23, 2009).

70. Dongfeng Motor Corporation, Corporate Profile, *supra* note 68.

71. *Id.* As R&D is a common avenue through which government subsidies are allocated, DFM's R&D financials will be further scrutinized in Part III of this Note. See *infra* Part III.

72. Dongfeng Motor Corporation, Corporate Profile, *supra* note 68.

73. *Dongfeng Automobile Co., Ltd. (600006: Shanghai Stock Exchange)*, BUS. WK., Nov. 16, 2007, available at <http://investing.businessweek.com/research/stocks/snapshot/snapshot.asp?capID=5493465>.

74. Shanghai Automotive Industry Corporation (Group): SAIC Group – Message from the Chairman, <http://www.saicgroup.com/English/sqjt/ldzc/index.shtml> (last visited Feb. 23, 2009) [hereinafter SAIC Group – Message from the Chairman].

75. Shanghai Automotive Industry Corporation (Group): SAIC Group – Introduction of SAIC, <http://www.saicgroup.com/English/sqjt/gsjz/index.shtml> (last visited Feb. 23, 2009) [hereinafter SAIC Group – Introduction of SAIC].

76. *Id.*

automobile manufacturer with an annual output of over 230,000 cars.<sup>77</sup> SAIC is also party to a joint venture with General Motors (GM), which is the largest Sino-American joint venture in China.<sup>78</sup>

The corporate strategy of SAIC under the leadership of President Shen Jianhua centers on the idea of “becoming a corporation of industrial investment and business operation that integrates advanced manufacturing and modern service businesses.”<sup>79</sup> One of its goals is to help build an energy-efficient, environmentally-friendly, and maintainable automobile industry.<sup>80</sup> To realize this goal, SAIC announced in October of 2007 that GM and SAIC will jointly be investing \$5 million in five years to establish a “vehicular energy technological R&D center” in coordination with Qinghua University, in order to devise a comprehensive energy strategy for China and its auto industry.<sup>81</sup>

The current largest of the “Big Three” Chinese auto manufactures is the same one that started it all for the Chinese auto industry in 1956: First Automotive Works (FAW).<sup>82</sup> FAW production bases are located in Jilin and Heilongjiang provinces in northeast China, Shandong province in east China, Hainan province in south China, and Sichuan and Yunnan provinces in southwest China.<sup>83</sup> While FAW initially only produced one model of medium truck, FAW now produces a diversified array of vehicles, including light, medium, and heavy-duty trucks; cars, buses and luxury tourist coaches, custom bus chassis, and compact vehicles.<sup>84</sup> Its sales volume has surpassed one million units annually.<sup>85</sup> FAW has multiple joint ventures with foreign manufacturers, the largest of which being Volkswagen, Toyota, and Mazda, which deal primarily with passenger vehicles.<sup>86</sup>

Under the leadership of President Zhu Yanfeng, the corporate strategy is currently to place heavier emphasis on the production of passenger vehicles while still holding a dominant position in the commercial truck sector.<sup>87</sup> FAW

77. EAST MIDLANDS, *supra* note 31.

78. *Id.*

79. SAIC Group – Introduction of SAIC, *supra* note 75.

80. SAIC Group – Message from the Chairman, *supra* note 74.

81. Shanghai Automotive Industry Corporation (Group): SAIC Group – News Center: *Deeper Cooperation Between GM and SAIC*, <http://www.saicgroup.com/english/xwzx/3682.shtml> (last visited Feb. 23, 2009).

82. FAW is ranked 470 in the Fortune Global 500 while SAIC is ranked 475; FAW revenues also exceeded SAIC revenues in 2006. *Fortune 500 Global: China First Automotive Works*, CNNMoney.com, <http://money.cnn.com/magazines/fortune/global500/2006/snapshots/4084.html> (last visited Feb. 23, 2009). *See also* China Carforums, FAW (First Automotive Works), <http://www.chinacarforums.com/FAW.html> (last visited Feb. 23, 2009).

83. FAW: About FAW: Profile, <http://www.faw.com/webcontent/aboutfaw.jsp?pros=profile.jsp&phight=850&about=Profile> (last visited Feb. 23, 2009) [hereinafter FAW: Profile].

84. *Id.*

85. *Id.*

86. FAW: International Cooperation: FAW-Volkswagen, FAW-Toyota, FAW-Mazda, <http://www.faw.com/international/volkswagen.jsp> (last visited Feb. 23, 2009).

87. FAW: Profile, *supra* note 83.

also focuses intently on R&D, possessing the largest and most comprehensive automotive R&D center in China.<sup>88</sup> In an effort to advance its research capabilities, FAW announced in August that it will be spending ¥13 billion over the next eight years “to enhance its competitiveness in the automobile, commercial truck, and bus sectors.”<sup>89</sup>

Although the Chinese auto industry had modest beginnings and endured several setbacks in times of war and political upheaval, it started to see rapid improvement in the mid-1980s as it became more technically advanced and more open to partnerships with foreign manufacturers.<sup>90</sup> China first passed the mark of two million units produced per year in 2000 (including all types of vehicles), and since then it has surpassed France, South Korea, and Germany in annual production rates.<sup>91</sup> By 2006, China had more than tripled its 2000 production output, producing a total of approximately 7.19 million units.<sup>92</sup> Not only is China still improving its own auto industry, but it is the only country in the world that continues to show substantial growth in production.<sup>93</sup> As China’s auto industry progresses exponentially and its major manufacturers aim to compete with Japanese and American giants, it becomes imperative now more than ever that the major players in the global auto industry secure assurance of fair international trade practices.<sup>94</sup>

## PART II: CHINA’S ACCESSION TO THE WTO, AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES, AND DISPUTE RESOLUTION

### A. *The Accession of the People’s Republic of China to the WTO*

On November 10, 2001, The Ministerial Conference of the WTO entered the following decision: “The People’s Republic of China may accede to the Marrakesh Agreement Establishing the World Trade Organization on the terms and conditions set out in the Protocol annexed to this decision.”<sup>95</sup> This marked a significant turning point in the dynamics of global trade. As China has become a booming economic power in itself over the past two decades,<sup>96</sup> this

88. *Id.* FAW’s R&D funding will also be further scrutinized in Part III of this note. See *infra* Part III.

89. FAW: News Releases 2007: *FAW Highlights Future R&D* (Aug. 11, 2007), <http://www.faw.com/webcontent/news.jsp> (last visited Feb. 23, 2009).

90. FAW: Profile, *supra* note 83.

91. COONEY, *supra* note 15.

92. Automotive Industry, <http://en.wikipedia.org/wiki/Automaker> (last visited Feb. 23, 2009).

93. COONEY, *supra* note 15.

94. *Id.* See also Vargo, Testimony Before the Subcommittee on Trade, *supra* note 17, at 2.

95. Accession of China, *supra* note 2.

96. Thomas Rumbaugh & Nicolas Blancher, *China: International Trade and WTO Accession* 1-25 (International Monetary Fund, Working Paper No. 36, 2004), available at

accession has meant enormous mutually advantageous trade opportunities for countries across the globe.<sup>97</sup> For example, in 2006 U.S. exports to China amounted to \$55.2 billion, marking an increase of 187% since China's accession to the WTO in 2001.<sup>98</sup> Similarly, EU exports to China have drastically increased: in 2006 alone EU exports increased by 22.5%, an increase amounting to €63 billion<sup>99</sup> (approximately \$79 billion U.S. dollars).<sup>100</sup> China's accession to the WTO has greatly enhanced multilateral and bilateral trade worldwide.<sup>101</sup> With this said, it is important for purposes of ensuring fair trade to consider the extent to which China is upholding its end of the agreements.<sup>102</sup>

In acceding to the WTO, China agreed to be bound by a series of regulations and policies which require it to not only restructure its laws to open its markets, but also to be transparent and accountable in its trade practices.<sup>103</sup> Article 2(C) of the Accession of the People's Republic of China delineates this transparency requirement: "China shall make available to WTO Members, upon request, all laws, regulations and other measures pertaining to or affecting trade in goods, services, TRIPS [trade-related aspects of intellectual property rights] or the control of foreign exchange before such measures are implemented or enforced."<sup>104</sup> The Accession agreement further provides that China's progress in implementing the WTO Agreement will be subject to annual review every year for eight years after accession.<sup>105</sup> The purpose of this is to ensure that China is moving toward policies of transparency.<sup>106</sup>

Having scrutinized China's steps toward fully implementing its WTO commitments over the first four to five years post-accession, experts have found mixed results.<sup>107</sup> On one hand, China has met several of the commitments<sup>108</sup> it was scheduled to fulfill by the fifth year of its WTO membership.<sup>109</sup> Some of the areas in which China is compliant include the "advertising, banking, architectur[e], engineering, urban planning services, insurance, distribution, and

<http://www.imf.org/external/pubs/ft/wp/2004/wp0436.pdf>.

97. U.S.-CHINA BUSINESS COUNCIL, *supra* note 4.

98. *Id.* at 1.

99. European Commission, Trade Issues, Bilateral Trade Relations: China, [http://ec.europa.eu/trade/issues/bilateral/countries/china/index\\_en.htm](http://ec.europa.eu/trade/issues/bilateral/countries/china/index_en.htm) (last visited Feb. 23, 2009).

100. This amount is calculated based on the exchange rate provided in *Foreign Exchange Rates (Annual)*, FED. RESERVE STATISTICAL RELEASE, (Federal Reserve) at 1 (2007), available at <http://www.federalreserve.gov/releases/g5a/20070103/>.

101. Rumbaugh & Blancher, *supra* note 96, at 3.

102. See THE U.S.-CHINA BUSINESS COUNCIL, *supra* note 4.

103. *Id.* See also KRAUSE, CHINA'S INDUSTRIAL POLICIES CONFLICT WITH WTO RULES, *supra* note 3.

104. Accession of China, *supra* note 2, at Part I.2.(C).

105. *Id.*

106. *Id.*

107. KRAUSE, CHINA'S INDUSTRIAL POLICIES CONFLICT WITH WTO RULES, *supra* note 3.

108. These commitments are provided in the Protocol annexed to the Accession of the People's Republic of China. See Accession of China, *supra* note 2, at art. 2.18.

109. THE U.S.-CHINA BUSINESS COUNCIL, *supra* note 4, at 3.

telecom sectors”;<sup>110</sup> however, there are still areas in which China continues to enforce policies that “effectively limit market access, impose conditions on market access, or give preferential treatment [to domestic industries].”<sup>111</sup> Examples are industry and export subsidies, both direct and indirect.<sup>112</sup> Upon accession, China was required to notify the WTO, in detail, of all of its subsidy programs, including all prohibited, actionable, and non-actionable subsidies pursuant to the Agreement on Subsidies and Countervailing Measures.<sup>113</sup> Finally, in April of 2006, China submitted a list of seventy-eight various programs – a list that was incomplete for its failure to include several substantial subsidies from local governments to Chinese industries.<sup>114</sup> Although there has been significant delay in notification to the WTO of its subsidization programs, this does not mean that the subsidies China employs are necessarily illegal. In fact, many of them may be legal and even “non-actionable”<sup>115</sup> according to the WTO.<sup>116</sup> The determination of whether China uses illegal subsidies, particularly in its automobile industry, depends on how its subsidies are categorized according to the Agreement on Subsidies and Countervailing Measures.

#### B. *Agreement on Subsidies and Countervailing Measures*

The WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement) addresses the problem of government support of domestic industries to the detriment of other countries participating in the same market.<sup>117</sup> The Agreement clearly defines what constitutes a subsidy according to the WTO, and it also provides remedial measures to those Member states that have been injured by another’s use of unacceptable subsidies.<sup>118</sup> The main purpose of the Agreement is to curtail government assistance that economically disadvantages other WTO Member states.<sup>119</sup> Article 1 of Part I of the SCM Agreement defines at length “subsidy” for purposes of the Agreement. It states:

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110. *Id.* at 2.

111. KRAUSE, CHINA’S INDUSTRIAL POLICIES CONFLICT WITH WTO RULES, *supra* note 3.

112. Vargo, Testimony Before the Subcommittee on Trade, *supra* note 17, at 4.

113. Accession of China, *supra* note 2, at Part I.2.(D).10. *See also infra*, Part II.B.

114. The United States initiated dispute resolution proceedings in 2007 through the WTO against China for implementing prohibited subsidies that have yet to be cancelled. Vargo, Testimony Before the Subcommittee on Trade, *supra* note 17, at 4.

115. Agreement on Subsidies and Countervailing Measures, *supra* note 12 at Part IV.

116. Vargo, Testimony Before the Subcommittee on Trade, *supra* note 17, at 4. *See also infra* Part II.B.

117. DEP’T OF FIN. CAN., SUBSIDIES AND COUNTERVAILING MEASURES INFORMATION PAPER (2007), available at [http://www.fin.gc.ca/activity/pubs/Sub\\_e.html](http://www.fin.gc.ca/activity/pubs/Sub_e.html) [hereinafter DEP’T OF FIN. CAN.].

118. *See* Agreement on Subsidies and Countervailing Measures, *supra* note 12 at Part II, art. 3.

119. DEP’T OF FIN. CAN., *supra* note 117.

[A] subsidy shall be deemed to exist if: (a)(1) there is a financial contribution by a government or any public body within the territory of a Member . . . i.e. where: (i) a government practice involves a direct transfer of funds . . . , potential direct transfers of funds or liabilities; (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits); (iii) a government provides goods or services other than general infrastructure, or purchases goods; (iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions in (i) to (iii) above which would normally be vested in the government . . . or (a)(2) there is any form of income or price support in the sense of Article XVI of GATT 1994; and (b) *a benefit is thereby conferred*.<sup>120</sup>

The extensiveness of this definition of “subsidy” illustrates that there are several methods by which a government could directly or indirectly provide financial support to industries within its borders.<sup>121</sup> Without any further limitations, it would be a monumental but futile effort to try to determine instances of subsidization because there would be no test by which to analyze potential subsidies. The SCM Agreement, however, establishes a specificity requirement, which deems that a subsidy will only be subject to the provisions of the SCM Agreement if it is “specific” according to Article 2 of the Agreement.<sup>122</sup>

A specific subsidy is one that is “specific to an enterprise or industry or group of enterprises or industries . . . within the jurisdiction of the granting authority” and is subject to a set of three principles.<sup>123</sup> First, “(a) [w]here the granting authority, or the legislation pursuant to which the granting authority operates, *explicitly* limits access to a subsidy to certain enterprises, such subsidy shall be specific.”<sup>124</sup> Second, if the granting authority or its legislation establishes criteria “(b) . . . governing the eligibility for, and the amount of, a subsidy, specificity *shall not* exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to.”<sup>125</sup> The third principal is a sort of catchall: if a subsidy is not specific under parts (a) or (b), it still may be found specific based on other factors such as: “use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to

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120. Agreement on Subsidies and Countervailing Measures, *supra* note 12, at Part 1, art. 1 (emphasis added).

121. *See id.*

122. *Id.* at Part I, art. 2.

123. *Id.*

124. *Id.* at Part I, art. 2.1(a) (emphasis added).

125. *Id.* at Part I, art. 2.1(b) (emphasis added).

certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy.”<sup>126</sup> In other words, if a certain subsidy seems too singular to a certain enterprise, it will be considered specific and therefore it will be subject to scrutiny under the SCM Agreement.<sup>127</sup> To summarize, Part I of the SCM Agreement defines “subsidy,” stipulates that in order for a subsidy to be subject to the provisions of the Agreement it must be “specific,” and then provides a three-part test to determine whether specificity exists for a given subsidy.<sup>128</sup>

Parts II, III, and IV of the SCM Agreement are crucial to the determination of whether a WTO Member state’s subsidization programs are illegal.<sup>129</sup> These sections of the Agreement respectively establish three categories of subsidies: Prohibited, Actionable, and Non-Actionable.<sup>130</sup> Subsidies are prohibited when they are “contingent, in law or in fact, whether solely or as one of several other conditions, upon *export performance*” or “contingent . . . upon the use of *domestic over imported goods*.”<sup>131</sup> This provision not only prohibits WTO Member states from granting such subsidies, but also requires Members to immediately terminate prohibited subsidies if they already existed in that country when it acceded to the WTO.<sup>132</sup> This has become a problem particularly with China; it was required per its Accession Agreement to notify the WTO of, and terminate, all prohibited subsidies upon accession.<sup>133</sup> As this commitment has yet to be fulfilled, the United States has initiated proceedings against China<sup>134</sup> according to WTO dispute resolution procedures.<sup>135</sup>

There are several reasons for prohibiting export subsidies and subsidies contingent upon use of domestic over imported goods.<sup>136</sup> One is that these types of subsidies heavily promote consumption of only domestically produced

126. *Id.* at Part I, art. 2.1(c).

127. *See id.*

128. *Id.* at Part I, art. 1-2.

129. *See generally id.* at Part II-IV (distinguishing between Prohibited, Actionable, and Non-Actionable Subsidies).

130. *Id.*

131. *Id.* at Part II, art. 3.1 (emphases added).

132. *Id.* at Part II, art. 3.2.

133. Accession of China, *supra* note 2, at Part I.2.(D).10.

134. National Association of Manufacturers, NAM Supports WTO Case on China’s Prohibited Subsidies, <http://www.nam.org/PolicyIssueInformation/InternationalEconomicAffairsPolicy/NewsReleases.aspx?DID=%7B3FD14137-B84C-4EB9-B518-2E2090CA6035%7D> (last visited Feb. 23, 2009). *See also*, *U.S. Starts Legal Action Against China at WTO Over Subsidies*, INT’L HERALD TRIBUNE, Feb. 2, 2007, at 1, available at <http://www.ihf.com/articles/2007/02/02/business/chitrade.php>.

135. Agreement on Subsidies and Countervailing Measures, *supra* note 12, at Part II, art. 3.2.

136. *See* Peter Morici, *Bernanke, Chinese Currency Subsidies and the “P” Word*, GLOBAL POLITICIAN, Dec. 19, 2006, at 1, available at <http://www.globalpolitician.com/22391-foreign-china>.

goods, which unfairly discriminates against foreign competitors.<sup>137</sup> Another is that they enable the subsidizing state to export at below-market prices, likewise undermining foreign competition.<sup>138</sup> Such unfair trade practices are what the WTO expressly aims to prevent.<sup>139</sup>

The second category of subsidies under the SCM Agreement is actionable subsidies.<sup>140</sup> A subsidy is actionable if it causes “adverse effects to the interests of other Members” such as “(a) injury to the domestic industry of another Member; (b) nullification or impairment of benefits accruing directly or indirectly to other Members . . . ; [or] (c) serious prejudice to the interests of another Member.”<sup>141</sup> The SCM Agreement then enumerates what constitutes serious prejudice: subsidization of a product in excess of fifteen percent, subsidization to cover operating losses of an industry or enterprise, and “direct forgiveness of debt.”<sup>142</sup> A country may be injured by this prejudice when the effect of the subsidy is to displace or impede its exports, to undercut its prices, or to increase the market share of the subsidizing state.<sup>143</sup> These subsidies may not always adversely affect other Member states; thus, the purpose of classifying them as “actionable” is to provide remedial measures to states that *do* suffer injury from these subsidies.<sup>144</sup>

The third category of subsidies is non-actionable subsidies. A subsidy is non-actionable if it is non-specific or if it is specific but meets the conditions outlined in Article 8 of the SCM Agreement.<sup>145</sup> Specific non-actionable subsidies include financial assistance with research, “assistance to disadvantaged regions,” or assistance in adapting existing facilities to comply with new environmental regulations.<sup>146</sup> These subsidies are non-actionable because they do not favor particular industries over others, and therefore do not foster a market advantage that would be detrimental to other Member states.<sup>147</sup> Non-actionable subsidies are beyond the concern of this Note insofar as they are not themselves illegal; therefore, China’s current use of them in the automobile industry would be of no legal consequence. However, non-actionable subsidies may be suspect in the sense that a country could foreseeably attempt to claim an actionable subsidy as non-actionable.<sup>148</sup> Lack

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137. See R. Pearce & R. Sharma, *II. Agreement on Agriculture, Module 3: Export Subsidies* in MULTILATERAL TRADE NEGOTIATIONS ON AGRICULTURE – A RESOURCE MANUAL, 1, 2-3, available at <http://www.fao.org/docrep/003/x7353e/X7353e03.htm>.

138. See *id.*

139. See Agreement on Subsidies and Countervailing Measures, *supra* note 12.

140. *Id.* at Part III, art. 5.

141. *Id.*

142. *Id.*

143. *Id.* at Part III, art. 6.

144. See *id.*

145. *Id.* at Part IV, art. 8.

146. *Id.*

147. Juris International, Rules Governing Subsidies on Industrial Products, <http://www.jurisint.org/pub/06/en/doc/C08.pdf> (last visited Feb. 23, 2009).

148. See SUSAN R. FLETCHER & MARY TIEMANN, TRADE AND ENVIRONMENT: GATT AND

of transparency in accounting, such as that which exists in China, could facilitate such a scheme.<sup>149</sup>

Of the three types of subsidies provided in the SCM Agreement, prohibited and actionable subsidies are of special importance for purposes of analyzing China's WTO compliance in the auto industry. These are the subsidies that amount to unfair trade practices, and these may have the most injurious effect on the United States and other world leaders in automobile production as China begins, or continues, to market its cars in these forums. Consideration of the remedies available to states injured by such illegal subsidization reveals that dispute resolution is largely left to the Member states themselves.<sup>150</sup>

### C. *Dispute Resolution Under the Agreement on Subsidies and Countervailing Measures*

Article 4 and Article 7 of the SCM Agreement provide for remedies in the event that one WTO Member state suspects that another is maintaining either prohibited or actionable subsidies, respectively.<sup>151</sup> The first step in the dispute resolution procedure in actions regarding prohibited subsidies is that the state claiming to have been injured by another's use of illegal subsidies initiates consultations with the allegedly offending state in an attempt to reach a solution between themselves.<sup>152</sup> If this fails after thirty days, either party may refer the matter to the Dispute Settlement Body (DSB) for establishment of a panel to resolve the dispute.<sup>153</sup> This DSB "aims to resolve disputes by clarifying the rules of the multilateral trading system; it cannot legislate or promulgate new rules."<sup>154</sup> The DSB's panel, with the assistance of a Permanent Group of Experts (PGE), reviews the evidence and allows the allegedly offending Member state to demonstrate that the practice in question is not a prohibited subsidy.<sup>155</sup> The panel then issues its conclusions, and if it finds that a prohibited subsidy exists, the DSB will recommend its immediate termination.<sup>156</sup> If this report is not followed within the time period allotted by the panel, the DSB may authorize the allegedly injured country to "take

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NAFTA 1-12 (1994), available at <http://www.nceonline.org/nle/crsreports/economics/econ-5.cfm>. See also, Institute for the Integration of Latin America and the Caribbean, Industrial Policies for Latin America, [http://www.iadb.org/intal/detalle\\_articulo.asp?idioma=eng&aid=17&cid=700](http://www.iadb.org/intal/detalle_articulo.asp?idioma=eng&aid=17&cid=700) (last visited Feb. 23, 2009).

149. See U.S.-CHINA BUSINESS COUNCIL, *supra* note 4.

150. See *infra* Part II.C.

151. Agreement on Subsidies and Countervailing Measures, *supra* note 12, at Part III-IV.

152. *Id.* at Part II, art. 4.

153. *Id.*

154. Center for Int'l Development at Harvard University: Global Trade Negotiations Home Page, Dispute Settlement Summary, <http://www.cid.harvard.edu/cidtrade/issues/dispute.html> (last visited Feb. 23, 2009) [hereinafter Center for Int'l Development at Harvard].

155. Agreement on Subsidies and Countervailing Measures, *supra* note 12, at Part II, art. 4.5.

156. *Id.* at art. 4.7.

appropriate countermeasures.”<sup>157</sup> The problem with this ultimate remedy is that the SCM Agreement does not define or otherwise expand upon the phrase “take appropriate countermeasures.”<sup>158</sup> This leaves enormous discretion to the Member states themselves, and it also greatly limits the authority of the WTO.<sup>159</sup>

The dispute resolution process for actionable subsidies is similar to that of prohibited subsidies.<sup>160</sup> One major difference is that, at the outset, the complaining state has the burden of proof to show that it has in fact sustained an injury.<sup>161</sup> The parties may then engage in consultations, as with prohibited subsidy dispute resolution, but in this case they have sixty instead of thirty days to reach a solution.<sup>162</sup> If that fails, a DSB-appointed panel will consider the matter and issue a report.<sup>163</sup> Finally, if an actionable subsidy is found to exist and has adversely affected another Member, the DSB will require the offending Member to remove the adverse effects or terminate the subsidy within sixty days.<sup>164</sup> If there is no compliance, the DSB will authorize “countermeasures, commensurate with the degree and nature of the adverse effects determined to exist . . . .”<sup>165</sup> This ambiguous language poses a problem similar to that of “appropriate countermeasures,” offered as the remedy for injury by prohibited subsidies.<sup>166</sup> The SCM Agreement does not provide any clarification regarding what type of action would be suitable.<sup>167</sup> When the ultimate means of recourse is “an eye for an eye”<sup>168</sup> counteraction between the parties themselves, the WTO seems to have washed its hands of dealing with any actual conflict.<sup>169</sup>

157. *Id.* at art. 4.10.

158. *Id.*

159. *Cf.* Center for Int'l Development at Harvard, *supra* note 154 (stating that the dispute resolution procedure “gives the WTO unprecedented power to resolve trade-related conflicts between nations and assign penalties and compensation to the parties involved”). For recommendations regarding the authority of the WTO and the dispute resolution system currently in place, see *infra*, Part IV-V.

160. See Agreement on Subsidies and Countervailing Measures, *supra* note 12, at Part III-IV.

161. *Id.* at Part III, art. 7.

162. *Id.*

163. *Id.*

164. *Id.*

165. *Id.*

166. J. Michael Finger & Julio Nogues, Abstract, *International Control of Subsidies and Countervailing Duties*, 1 WORLD BANK ECON. REV. 4, 707-725 (1987), available at <http://www.wber.oxfordjournals.org/cgi/content/abstract/1/4/707> (stating the “code on subsidies and countervailing duties is ambiguous in its definition of ‘legal’ subsidies, and thus in the appropriate use of countervailing duties”).

167. See *id.* See also Agreement on Subsidies and Countervailing Measures, *supra* note 12, at Part III, art. 7.

168. Known also as the Law of Retribution, the Bible describes this concept in *Exodus* 21: 22-27.

169. The phrase “washing ones hands” comes from the Bible and refers to Pontius Pilot washing his hands to symbolize his refusal to take action or responsibility for the crucifixion of Jesus Christ. *Matthew* 27: 24.

Again, this leads to the conclusion that the WTO has extremely limited authority. Some Member states, such as China, may find this to be a disincentive to comply with WTO regulations in the first place.<sup>170</sup> Part V of this Note will reexamine these remedies in light of evidence of subsidization practices currently employed in the global auto industry.<sup>171</sup>

When China acceded to the WTO, it became party to a number of agreements, including the Agreement on Subsidies and Countervailing Measures.<sup>172</sup> China thereby incurred the commitment to notify the WTO of any and all subsidies it had in place, a commitment which has yet to be fulfilled even after the United States and Mexico initiated WTO cases against China.<sup>173</sup> Although progress in Chinese transparency with regard to subsidies has been relatively unhurried,<sup>174</sup> this does not mean its subsidies are per se illegal.<sup>175</sup> We have seen that there are three categories of subsidies, only one of which is always illegal, and another of which is only illegal depending on whether it adversely affects other states.<sup>176</sup> These two – prohibited and actionable subsidies, respectively – pose significant problems for fair trade.<sup>177</sup> Keeping in mind China's commitments and WTO law on subsidies, let us revisit the Chinese auto industry to determine the extent to which China is WTO-compliant in this microcosm of global trade.

### PART III: DETERMINING DEGREES OF SUBSIDIZATION: CHINA COMPARED WITH WORLD LEADERS IN THE AUTOMOBILE INDUSTRY

#### A. *Methodology for Calculating Subsidy Amounts*

Part V, Article 14 of the SCM Agreement enumerates guidelines for the “[c]alculation of the [a]mount of a [s]ubsidy in [t]erms of the [b]enefit to the

170. For recommendations on improvements in the SCM Agreement dispute resolution process and amplifying the authority of the WTO, see *infra* Part V.

171. See *infra* Part V.

172. See Accession of China, *supra* note 2, at Part I.2.(D).10.

173. Press Release, The Office of the United States Trade Representative, United States Files WTO Case Against China Over Prohibited Subsidies (Feb. 2, 2007) (on file with author). This case was then purportedly resolved as of Nov. 29, 2007, when it was announced that, pursuant to a Memorandum of Understanding (MOU) between the United States and China, China agreed to ensure that by Jan. 1, 2008, all prohibited subsidies complained of would be permanently terminated, never to be reinstated. The United States tellingly reserved its right to reinstate proceedings. Press Release, The Office of the United States Trade Representative, China to End Subsidies Challenged by the United States in WTO Dispute (Nov. 29, 2007) (on file with author). It is unclear whether China has followed the MOU to date.

174. U.S.-CHINA BUSINESS COUNCIL, *supra* note 4, at 3.

175. See Agreement on Subsidies and Countervailing Measures, *supra* note 12, at Part II, art. 3.

176. See *id.*

177. See Morici, *supra* note 136.

[r]ecipient.”<sup>178</sup> The following are not considered to confer benefits unless they are provided in a manner inconsistent with how the enterprise would otherwise conduct business with a private entity: “government provision of equity capital,” “a loan by a government,” “a loan guarantee by a government,” and “the provision of goods or services or purchase of goods by a government.”<sup>179</sup>

While this places some limitations on what can be considered a subsidy, it does not give any guidance as to how to *calculate* subsidy amounts.<sup>180</sup> A logical method of calculating the subsidies granted to a certain corporation is to look at the company’s financial statements.<sup>181</sup> A firm might disclose the amount of government assistance it receives annually, although this is rare and there may be no telling whether this number is comprehensive of all types of subsidies.<sup>182</sup>

If there are no direct disclosures, one may find subsidies by scrutinizing the income taxes paid (as compared to national corporate income tax rates), research and development grants, and interest rates paid on loans (as compared to standard interest rates).<sup>183</sup>

The above methods for determining subsidies may or may not render accurate results. As Economic Analyst Andrew Szamosszegi aptly notes, “Quantification is difficult because much of the raw data and information required to calculate subsidies is unavailable.”<sup>184</sup> Even if the information does exist, access to this may be very restricted:

In a subsidy investigation, the Department of Commerce collects detailed data from mandatory respondents and the subsidizing government. The Department then sends officials to view the books of the respondents and verify the information received. This information is only seen by officials and people who certify that they will not divulge any

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178. Agreement on Subsidies and Countervailing Measures, *supra* note 12, at Part V, art. 14.

179. *Id.*

180. *See id.*

181. This is the author’s proposal and has been confirmed as a valid method of calculating subsidies by persons with knowledge in the field. Interview with Richard L. Rogers, Professor of Accounting, Ind. Univ. Kelley School of Bus. – Indianapolis in Indianapolis, Ind. (Oct. 17, 2007); E-mail from Andrew Szamosszegi, Economic Analyst, Capital Trade, Inc., to Ann E. Christoff, Indiana International & Comparative Law Review, Ind. Univ. School of Law – Indianapolis (Nov. 14, 2007, 4:20p.m. CST) (on file with author).

182. One example of a company that has disclosed a single subsidy amount in its annual report is Toyota. Toyota Motor Corp., Annual Report (Form 10-K), at 82 (Mar. 31, 2007), available at [http://www.toyota.co.jp/en/ir/library/annual/pdf/2007/ar07\\_e.pdf](http://www.toyota.co.jp/en/ir/library/annual/pdf/2007/ar07_e.pdf). *See also infra* Part III.C.

183. E-mail from Andrew Szamosszegi, Economic Analyst, Capital Trade, Inc., to Ann E. Christoff, Indiana International & Comparative Law Review, Ind. Univ. School of Law – Indianapolis (Nov. 14, 2007, 4:20p.m. CST) (on file with author).

184. E-mail from Andrew Szamosszegi, Economic Analyst, Capital Trade, Inc., to Ann E. Christoff, Indiana International & Comparative Law Review, Ind. Univ. School of Law – Indianapolis (Nov. 14, 2007, 9:16a.m. CST) (on file with author).

proprietary information.<sup>185</sup>

Thus, with limited access to limited information, the subsidization amounts calculated and discussed herein should be considered rough estimates.<sup>186</sup> In some cases, even basic financial information is unavailable, thus affording no basis (for the purposes of this Note) for determining figures.<sup>187</sup>

#### B. *Subsidy Estimates: The Chinese “Big Three” Auto Manufacturers*

To recall from Part I, the Chinese “Big Three” in the automobile industry include First Automotive Works (FAW), Shanghai Automotive Industry Corporation (SAIC), and Dongfeng Motors Corporation (DFM).<sup>188</sup> For the year 2006, FAW’s income was ¥163.7 billion,<sup>189</sup> and its assets are currently valued at ¥102.4 billion (\$12.4 billion).<sup>190</sup> It is not clear, however, what amount of this income and what percentage of these assets come through government assistance. While FAW does ostensibly post its annual reports on its website, they are only illegible pictures of the annual reports and not the documents themselves.<sup>191</sup> No other means of accessing the reports seems available at this time without purchasing the information for a heavy price.<sup>192</sup> While this information would be highly useful for analysis, its absence nonetheless strongly supports a conclusion of lacking Chinese transparency and a recommendation that the annual reports of all companies under the umbrella of the WTO should be publicly available to other Member states.<sup>193</sup> Further, these annual reports should be required to be prepared in accordance with a standard set of accounting principles which the WTO should adopt. This will heighten accountability of trade practices worldwide. Further discussion of these recommendations continues in Part IV.<sup>194</sup>

SAIC posts its annual reports on its website, although they are virtually

185. *Id.*

186. *See infra* Part III.B.

187. One example of a company that does not publicize its financial information is Kia Motors Corp. *See* Kia Motors, <http://www.kia.com/index.php>. *See also infra*, Part III.C.

188 *See generally* China Carforums, <http://www.chinacarforums.com/forum/index.php> (last visited Feb. 23, 2009).

189. FAW, Financial Data, <http://www.faw.com/webcontent/aboutfaw.jsp?pro=FinancialData.jsp&phight=850&about=Financial%20Data> (last visited Feb. 23, 2009).

190. Just-Auto, Factsheets, First Automotive Works, <http://www.just-auto.com/factsheet.aspx?ID=217> (last visited Feb. 23, 2009).

191. FAW, Annual Report, [http://www.faw.com/webcontent/aboutfaw.jsp?pro=annualreport\\_2004.htm&phight=500&about=Annual%20Reports](http://www.faw.com/webcontent/aboutfaw.jsp?pro=annualreport_2004.htm&phight=500&about=Annual%20Reports) (last visited Feb. 23, 2009).

192. One publication comparing the Annual Reports of FAW, SAIC, and Dongfeng, etc. is priced at \$1,519.00. FriedlNet, Automotive, Brand Competitiveness of China’s Automobile Annual Report 2006-2007, [http://www.friedlnet.com/product\\_info.php?products\\_id=5207&osCsid=7f46da34172a41920da891fd6c4181e0](http://www.friedlnet.com/product_info.php?products_id=5207&osCsid=7f46da34172a41920da891fd6c4181e0) (last visited Feb. 23, 2009).

193. For a discussion of this recommendation, *see infra* Part IV.

194. *See infra*, Part IV.

unrecognizable as such; they do not include any financial statements, are approximately three pages long, and contain only a brief overview of their business during the fiscal year.<sup>195</sup> Although this is limited information, there are still disclosures that arouse suspicion in terms of subsidies. For example, the company states, "We focus on research and application of new technology and new energy, including hybrid, alternative energy and hydrogen in order to reduce the energy consumption and create more environmental emission."<sup>196</sup> Since government grants often fund research and development (especially in the interest of reducing energy consumption), it would be prudent to review these funds for their legality under the SCM Agreement.<sup>197</sup>

Another suspect portion of the Annual Report is the section entitled "International Operation."<sup>198</sup> Here, SAIC boasts that its exports grew 174% from 2005 to 2006, with exports at 6,724 units in 2006.<sup>199</sup> Such a drastic increase in one year, with no accompanying explanation, may have partially been the result of government incentives to increase export production.<sup>200</sup> The Chinese government may have subsidized the country's largest automobile exporters, including SAIC, contingent on their export performance, in an effort to increase national export volume.<sup>201</sup> It may prove beneficial to further investigate this export increase for illegal government assistance.

DFM, the third auto manufacturer of the Chinese "Big Three," does not furnish annual reports on its website.<sup>202</sup> However, evidence of specific subsidies to DFM is available through a recent study submitted to the U.S. International Trade Commission.<sup>203</sup> One area of concern with DFM is its access to preferential loans.<sup>204</sup> "The effective interest rates on [DFM's] current loans are as low as 1.69 percent, while rates on long-term loans are as low as

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195. See Shanghai Automotive Industry Corporation (Group), 2006 Annual Report, <http://www.saicgroup.com/English/sqjt/gsnb/2006njtnb/gzhg/index.shtml> (last visited Feb. 23, 2009 [hereinafter, SAIC Annual Report]).

196. *Id.*

197. See generally E-mail from Andrew Szamosszegi, Economic Analyst, Capital Trade, Inc., to Ann E. Christoff, Indiana International & Comparative Law Review, Ind. Univ. School of Law – Indianapolis (Nov. 14, 2007, 9:16a.m. CST) (on file with author).

198. SAIC Annual Report, *supra* note 195.

199. *Id.*

200. Chinese Vice Minister of Commerce Wei Jianguo announced in 2006 that China's goal was to "lift the value of its vehicle and auto exports to . . . ten percent of the world's total vehicle trading volume in the next 10 years." *China Plans Stricter Auto Export Rules*, CHINADAILY (Beijing), Jan. 2, 2007, available at [http://www.chinadaily.com.cn/china/2007-01/02/content\\_773224.htm](http://www.chinadaily.com.cn/china/2007-01/02/content_773224.htm).

201. See *id.* See also, Aervitz, *supra* note 20.

202. Dongfeng Motor Corporation, Corporate Profile, [http://www.dfmc.com.cn/info/introduce\\_en.aspx](http://www.dfmc.com.cn/info/introduce_en.aspx) (last visited Feb. 23, 2009).

203. ANDREW SZAMOSSZEGI, GOVERNMENT POLICIES AFFECTING U.S. TRADE IN SELECTED SECTORS: CHINA, INV. NO. 332-491: ANDREW SZAMOSSZEGI'S POST-HEARING SUBMISSION – ANSWERS TO COMMISSIONER'S QUESTIONS (2007).

204. *Id.* at 2.

two percent.”<sup>205</sup> However, “market-based interest rates in 2005 were approximately 9.4 percent for short-term loans and 10.4 percent for long-term loans.”<sup>206</sup> The difference between the interest expense of ¥694 million and ¥485 million actually paid in interest amounts to ¥209 million.<sup>207</sup> A second area of concern is R&D incentives.<sup>208</sup> DFM received government grants of ¥464 million in 2005 for research and development in automotive technology.<sup>209</sup> While this subsidy is not prohibited under the SCM Agreement, it may be actionable depending on whether it has adverse effects on other Member states.<sup>210</sup>

Subsidies in the form of R&D grants and export subsidies are suspected for SAIC,<sup>211</sup> and subsidies have been more affirmatively calculated for DFM in the form of R&D grants and preferential loans.<sup>212</sup> These areas of subsidization vary in terms of legality under the SCM Agreement.<sup>213</sup> For example, if an export subsidy was found to exist for SAIC, fostering SAIC’s immense improvement in export volume, this would amount to a prohibited subsidy and would need to be eliminated immediately.<sup>214</sup> As another example, government loans may look like non-actionable subsidies, although when the government lends preferentially by reducing the interest rates, this would amount to an actionable subsidy because it favors a particular industry or enterprise.<sup>215</sup> These subsidies are based only on the companies’ annual reports, which are not necessarily accurate in themselves.<sup>216</sup> A strict set of WTO accounting principles and specific transparency requirements, coupled with heightened WTO authority, would theoretically bring about Chinese auto manufacturers’ full disclosure of their finances, including government assistance.

### C. *Subsidy Estimates for the Other World Leaders in the Automobile Industry*

We have seen that China likely grants subsidies to its major auto manufacturers – subsidies which remain undisclosed. However, if the largest auto manufacturers in the world engage in the same practices, then the question whether there is really unfair trade in the industry becomes more difficult to

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205. *Id.*

206. *Id.*

207. *Id.* at 3.

208. *Id.*

209. *Id.*

210. *See* Agreement on Subsidies and Countervailing Measures, *supra* note 12, at Part III, art. 5.

211. SAIC Annual Report, *supra* note 195. *See also* China Plans Stricter Auto Export Rules, *supra* note 200.

212. SZAMOSSZEGI, *supra* note 203, at 3-4.

213. *See* Agreement on Subsidies and Countervailing Measures, *supra* note 12, at Part II.

214. *Id.*

215. *Id.* at Part III, art. 6.

216. *See* SZAMOSSZEGI, *supra* note 203, at 2.

answer, and the WTO's ability to control subsidization becomes compromised. In terms of motor vehicle production, the current world leaders in the auto industry include, in descending rank: Japan, the United States, China, Germany, and South Korea.<sup>217</sup> An investigation into the extent of subsidization for the top manufacturer of each of these countries will help determine whether the leading nations in the industry are WTO-compliant and how authoritative the WTO regulations actually are.

Japan's largest auto manufacturer, also the largest in the world, is Toyota Motor Corporation.<sup>218</sup> In its 2007 Annual Report, Toyota disclosed that it saw a reduction in operating expenses of ¥47.2 billion during the fiscal year of 2005.<sup>219</sup> This reduction represents the "difference between the benefit obligations of the substitutional portion and the government-specified portion of plan assets of ¥121.5 billion for fiscal 2005 which was transferred to the government."<sup>220</sup> While this subsidy may be actionable if it has adverse effects on other states, it is likely non-actionable because it does not favor this particular enterprise.<sup>221</sup>

One major U.S. auto manufacturer is Ford.<sup>222</sup> Ford disclosed in its 2006 Annual Report that it received a federal subsidy pursuant to The Medicare Prescription Drug Improvement and Modernization Act of 2003, a subsidy used to fund retiree drug benefits.<sup>223</sup> This subsidy resulted in a reduction in the 2006 retirement benefits expense by \$270 million.<sup>224</sup> According to the SCM Agreement, this would likely be categorized as a non-actionable subsidy because it is not specific.<sup>225</sup> Recall that in order to be specific, a subsidy must affect a certain industry or enterprise; whereas the subsidy in this case is mandated by legislation and would affect employees across all U.S. industries.<sup>226</sup> Although this is the only subsidy that it discloses, Ford, like Toyota, publishes comprehensive annual reports with detailed explanations of its financial statements.<sup>227</sup> Thus, even if these companies do not expressly claim all of their subsidies, calculating subsidy amounts is not as difficult for

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217. Automotive Industry, *supra* note 92.

218. *Id.*

219. Toyota Motor Corp., Annual Report (Form 10-K) at 82 (Mar. 31, 2007), available at [http://www.toyota.co.jp/en/ir/library/annual/pdf/2007/ar07\\_e.pdf](http://www.toyota.co.jp/en/ir/library/annual/pdf/2007/ar07_e.pdf) [hereinafter Toyota Annual Report]. Also note: these amounts are in Japanese Yen. The symbol "¥" is used to denote both Chinese and Japanese currency. International Currency Symbols, [http://www.lingo24.com/currency\\_symbols.html](http://www.lingo24.com/currency_symbols.html) (last visited Feb. 23, 2009).

220. *Id.*

221. See Agreement on Subsidies and Countervailing Measures, *supra* note 12, at Part IV.

222. Automotive Industry, *supra* note 92.

223. Ford Motor Co., 2006 Annual Report (Form 10-K), at 94 (Mar. 7 2007), available at [http://www.ford.com/doc/2006\\_AR.pdf](http://www.ford.com/doc/2006_AR.pdf) [hereinafter Ford Annual Report].

224. *Id.*

225. See Agreement on Subsidies and Countervailing Measures, *supra* note 12, at Part IV, art. 8.

226. *Id.*

227. Ford Annual Report, *supra* note 223; and Toyota Annual Report, *supra* note 219.

these companies as it is for Chinese manufacturers who publish only limited information and in minimally functional format.

The largest German auto manufacturer is Volkswagen.<sup>228</sup> While this company does not disclose any government subsidies in its Annual Report, there are suspect areas where Volkswagen may be receiving undisclosed government assistance.<sup>229</sup> In its Notes to the Consolidated Financial Statements, under Revenue and Expense Recognition, the report notes that “[g]overnment grants are generally deducted from the cost of the relevant assets.”<sup>230</sup> There is no further explanation.<sup>231</sup> If these are grants to cover debt repayment, and they have an adverse effect on other states, they would be deemed actionable subsidies according to the SCM Agreement.<sup>232</sup> Further investigation would be necessary to determine specifically what the subsidy’s function is here. It should be noted that, Volkswagen, like Toyota and Ford, also publishes comprehensive annual reports including financial statements and explanatory notes.<sup>233</sup> This practice greatly enhances transparency and should be promoted by the WTO.

Finally, the largest Korean auto manufacturers are Hyundai Motors and Kia Motors.<sup>234</sup> These both trade on the Korean Stock Exchange, and although Kia publishes its consolidated financial reports on its website, Hyundai does not.<sup>235</sup> Hyundai’s lack of available information reinforces the conclusion that transparency in accounting is crucial to the WTO ability to determine whether illegal subsidization occurs.

This survey indicates that, like the major Chinese auto manufacturers, other world leaders in the auto industry also receive government subsidies.<sup>236</sup> However, the other world leaders are clearly distinguishable from the Chinese manufacturers: with the exception of Hyundai, the largest manufacturers of the other leading countries all publish very thorough annual reports, which not only include financial statements, but provide accompanying explanatory notes as well.<sup>237</sup> While calculating precise subsidy amounts is beyond the scope of this

228. Automotive Industry, *supra* note 92.

229. Volkswagen Group, Annual Report (Form 10-K) (Mar. 31, 2007), available at [http://www.volkswagenag.com/vwag/vwcorp/info\\_center/en/publications/2008/03/Annual\\_Report\\_2007-.bin.acq/qual-BinaryStorageItem.Single.File/VW\\_AG\\_GB\\_2007\\_en.pdf](http://www.volkswagenag.com/vwag/vwcorp/info_center/en/publications/2008/03/Annual_Report_2007-.bin.acq/qual-BinaryStorageItem.Single.File/VW_AG_GB_2007_en.pdf) [hereinafter Volkswagen Annual Report].

230. *Id.* at 196.

231. *See id.*

232. *See* Agreement on Subsidies and Countervailing Measures, *supra* note 12, at Part III, art. 6.

233. *See* Volkswagen Annual Report, *supra* note 229.

234. Automotive Industry, *supra* note 92.

235. *See* Hyundai, <http://www.hyundaiusa.com/abouthyundai/ourcompany/home.aspx> (last visited Feb. 23, 2009); Kia Motors, <http://www.kmcir.com/eng/kire3000/kire3300.aspx> (last visited Feb. 23, 2009).

236. *See supra* Part III.C.

237. Ford Annual Report, *supra* note 223; Toyota Annual Report, *supra* note 219; and Volkswagen Annual Report, *supra* note 229.

Note, exemplifying certain areas of concern characterized by sparse disclosure still invites a reconsideration of the SCM Agreement's authority and the authority of the WTO more broadly.<sup>238</sup>

#### PART IV: REASSESSMENT OF REMEDIES UNDER THE SCM AGREEMENT AND THE AUTHORITY OF THE WTO

##### A. *The Effectiveness of Available Remedies in the SCM Agreement*

Very little, if any, concrete evidence actually exists as to illegal Chinese subsidization in its auto industry.<sup>239</sup> This is in large part because there is a general "lack of subsidy statistics and transparency in SOE [state-owned enterprise] operations," and as Chinese auto manufacturers are SOEs which conform to this generalization, it is extremely difficult to determine the extent to which China subsidizes its auto industry.<sup>240</sup> While other WTO Member states may have some evidence against China of unfair trade practices, such as gross price disparity between Chinese prices and competitors' prices, without the availability of accurate financial information, they may find it highly problematic to establish a case of prohibited subsidization.<sup>241</sup> On a larger scale, if compliant Member states do not have the means to hold suspected noncompliant Member states accountable, merely because financial information is distorted or unavailable, then ultimately they have limited or no recourse for economic injury under the WTO. In the event that the world leaders in the auto industry have no recourse against China for illegal subsidization of its auto manufacturers, simply for lack of financial data for the Chinese industry, then China could theoretically begin selling automobiles in the United States and other countries at artificially low prices. Thus, China would be engaging in unfair competition and potentially serving a destructive blow to American and other foreign auto manufacturers. In sum, if the WTO is to truly serve as the facilitator and regulator of free international trade, then it is imperative that its dispute resolution system provide adequate remedies for injury caused by WTO violations.

To revisit dispute resolution as introduced in Part II.C, further analysis of the remedies and countervailing measures provided in the SCM Agreement will shed light on their ambiguities and deficiencies.<sup>242</sup> In a case involving *proven* prohibited subsidies, if the offending state does not follow the DSB panel recommendation to withdraw the subsidy within the allotted time period, "the DSB shall grant authorization to the complaining Member to take appropriate

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238. Agreement on Subsidies and Countervailing Measures, *supra* note 12.

239. *See supra* Part III.B.

240. Julia Ya Qin, *WTO Regulation of Subsidies to State-Owned Enterprises (SOEs) – A Critical Appraisal of the China Accession Protocol*, 7 J. OF INT'L ECON. L. 863, 882 (2004).

241. *See Vargo*, Testimony Before the Subcommittee on Trade, *supra* note 17, at 2.

242. *See supra* Part II.C.

countermeasures.”<sup>243</sup> This provision essentially says that if dispute resolution in the WTO forum fails, then the injured country has discretion to correct the situation itself.<sup>244</sup> To analogize, if an American trial court rendered a judgment against a defendant, and the defendant then refused to pay damages within the specified time period, this would be akin to the court then authorizing the plaintiff to engage in self-help to recover whatever damages he/she could. The more logical approach would be to impose fines on the defendant or sentence the defendant to confinement in order to avoid further injury to either party. Similarly, a more efficient and sensible WTO remedial scheme would involve fines for established cases of prohibited subsidization or, depending on the severity and continuity of the violation, expulsion from the organization. If a Member state must ultimately handle its own economic grievances, then the findings of WTO dispute resolution proceedings are non-binding.<sup>245</sup> They become mere suggestions that the offending state desist its violation, and they fail as actual remedies.

Where injurious subsidization has been found and the offending state has not terminated the subsidy, the complaining state may impose countervailing duties “only as long as and to the extent necessary to counteract subsidization which is causing injury.”<sup>246</sup> This removes any incentive the offending state may have had to withdraw the subsidy; if it subsidizes to its benefit against the world, and only certain other states impose countervailing duties, then the offending state still benefits from the subsidy and is not deterred from maintaining it. Two paragraphs later, the SCM Agreement says, “[n]otwithstanding [the above duration provision], any definitive countervailing duty shall be terminated on a date not later than five years from its imposition . . . unless the authorities determine . . . that the expiry of the duty would be likely to lead to continuation or recurrence of subsidization and injury.”<sup>247</sup> In other words, the injured state may impose countervailing duties for as long as the subsidizing state wishes to maintain its illegal subsidy. Again, the subsidizing state would have no incentive to cancel the injurious subsidy, and so it could continue violating the SCM Agreement with virtually no consequence while simultaneously reaping the benefits of the illegal subsidy.

The remedies provided in the SCM Agreement for injury by subsidization are inefficient and ineffective. They are inefficient in the sense that the dispute resolution process may take several months and generate substantial administrative costs, only for the problem to be deferred back to the complaining state to counteract appropriately.<sup>248</sup> Further, the subsidizing state

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243. Agreement on Subsidies and Countervailing Measures, *supra* note 12, at Part II. art. 4.10.

244. *See id.*

245. *See id.*

246. *Id.* at Part V, art. 21.1.

247. *Id.* at Part V, art. 21.3.

248. *Id.* at Part II.

would likely have little interest in reaching an agreement through dispute resolution when it could simply ignore any recommendation to terminate the subsidy and wait for the complaining state to use countermeasures against it.<sup>249</sup> The SCM Agreement remedies are ineffective in that they do not provide the aggrieved state with any assurance that the illegal subsidy at issue, or others, will not be utilized against the state again, that they do not provide terms of compensation to the injured state, that there is no binding power of the DSB's recommendations, and that they ultimately allow the states to decide on subsidization counteractions themselves.<sup>250</sup>

*B. The Weight of Authority of WTO and the Importance of a System of International Trade That Calls for Transparency*

The WTO is a unique international organization in that it is operated entirely by its Member states, and there is no concentration of power in any organizational head or board of directors.<sup>251</sup> As such, the Member states ultimately determine the course of action in disputes in areas such as illegal subsidization.<sup>252</sup> This could be considered either a great source of power or a great weakness; however, unless the WTO can require of its Member states accurate accounting and transparency in terms of finances and trading policies, and successfully demand their reform in the face of deficiency, the WTO cannot be understood as a body of any great authority. Furthermore, the power of the WTO is only as great as its members' willingness to abide by the agreements they have adopted. Therefore, if a state can violate its WTO obligations by illegally subsidizing an industry, ignore directions to terminate the subsidy, and wait until the injured country counteracts, when ultimately the dispute is out of the WTO's control and is left to the injured state, the WTO has diminished authority. As the WTO itself states, "the preferred solution is for the countries concerned to discuss their problems and settle the dispute by themselves."<sup>253</sup> While this Member-run approach evidences strength in democracy, it also functions as a limit to authority: the Member states have final say, as opposed to a governing body within the organization.

The automotive industry is the largest manufacturing industry in the United States,<sup>254</sup> and it will face intense competition in the years ahead as China rises as an automotive superpower.<sup>255</sup> Therefore, it should be a major U.S.

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249. *See id.*

250. *See id.*

251. Understanding the WTO: The Organization: Whose WTO is it Anyway?, [http://www.wto.org/English/thewto\\_e/whatis\\_e/tif\\_e/org1\\_e.htm](http://www.wto.org/English/thewto_e/whatis_e/tif_e/org1_e.htm) (last visited Feb. 23, 2009).

252. Agreement on Subsidies and Countervailing Measures, *supra* note 12, at Part II, art. 4.

253. Understanding the WTO: Settling Disputes: A Unique Contribution, [http://www.wto.org/English/thewto\\_e/whatis\\_e/tif\\_e/displ\\_e.htm](http://www.wto.org/English/thewto_e/whatis_e/tif_e/displ_e.htm) (last visited Feb. 23, 2009).

254. ECON & BUS GROUP, CENTER FOR AUTOMOTIVE RESEARCH, THE CONTRIBUTION OF THE INTERNATIONAL AUTO SECTOR TO THE U.S. ECONOMY: AN UPDATE 2 (2005).

255. InTech: China Rises as Auto-Parts Power, <http://www.isa.org/>

priority to ensure that global competitors in this industry and others are engaging in fair trade practices. In order to do this, a system must first be in place for regulating and promoting international trade that requires transparency and accountability. Absent such accountability, states utilizing the system could engage in unfair trade practices while other states are unable to prove it for lack of transparent financial information. While the WTO serves to facilitate free international trade, it does not yet require a uniform degree of accountability of its Member states, and it is unable to sufficiently protect Member states from economic injury. An enhancement of the WTO to require transparency of all of its Member states would increase the authority of the WTO so that it would be better able to guard against unfair trade practices. Specifically in the context of the auto industry, if the WTO would require transparent financial accounting of China's major auto manufacturers, evidence of illegal subsidies may surface, as it has in other industries.<sup>256</sup> In light of such evidence, the United States would be able to guard against Chinese auto imports that would be sold on U.S. soil at extremely low prices to the detriment of the U.S. auto industry. This would allow the United States to protect its economy from injury due to unfair trade in the form of illegal subsidization. Imposing the conditions of transparency and accountability on Member states before they are allowed to gain or maintain membership to the WTO would serve as a filter of unfair trade, and would ultimately protect national economies, especially that of the United States, from economic injury.

#### PART V: CONCLUSION AND RECOMMENDATIONS

As China continues to penetrate the global automobile market, it is essential to fair trade and to the well-being of domestic industries of the United States and other countries that China honors its WTO commitments. China's unique accounting principles lend themselves to confusion and suspicion, as access to accurate financial information is extremely difficult to obtain.<sup>257</sup> Although China is likely not the only WTO Member state that fails to disclose all of its government subsidies, other states in the auto industry at least make comprehensive accounts of their finances available.<sup>258</sup> These ideas of transparency and clear accounting lead to two major recommendations.

The first recommendation is that the WTO should implement a set of standards which all national accounting systems must meet. One such standard would be periodic publication of financial information by one approved Board per Member state. This would eliminate unnecessary variation in accounting form. Another standard would be one of permanence, requiring that a company's financial information be available for the current year and years

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InTechTemplate.cfm?Section=Departments5&template=/ContentManagement/ContentDisplay.cfm&ContentID=55745 (last visited Feb. 23, 2009).

256. Vargo, Testimony Before the Subcommittee on Trade, *supra* note 17, at 2.

257. See *supra* Part III.B.

258. See *supra* Part III.

prior for comparison purposes.<sup>259</sup> Others would include consistency of terms, prudence in reporting, and comprehensiveness in terms of reporting all relevant financial information.<sup>260</sup> While these are general examples, the WTO should implement a detailed set of criteria that requires the same depth of information, regardless of format and publisher, of all Member states. This set of principles should be modeled in consideration of the Generally Accepted Accounting Principles of the largest five Member states and the International Financial Reporting Standards. The adopted set of accounting principles would function as a check against any miscommunication or nondisclosure based on unique domestic accounting principles at odds with those of the WTO.

The second recommendation is that the WTO should make its remedial measures stricter in cases involving prohibited and actionable subsidies. At present, the remedies available to injured countries ultimately are left to the country's own discretion. While this provides a great degree of freedom to handle the dispute as necessary, it also undermines the authority of the WTO if Member states know they will never be held accountable by the WTO. Examples of more stringent remedial measures include a financial penalty for proven use of prohibited subsidies, similar to the contracts concept of liquidated damages: if there is a breach of the SCM Agreement, the breaching state automatically agrees to pay a certain amount to the WTO. Further, the offending state would have to compensate the injured state for all losses resulting from the subsidy within a time period specified by the DSB. The offending state would also be required to terminate the subsidy within a specified time period. Failure to abide by these rules and other enhanced remedies would result in more fines, and ultimately, the threatened expulsion of the offending state from the organization. Stricter remedial measures and heightened consequences would provide a disincentive for Member states to engage in injurious subsidization.

As China prepares to launch its automobiles in the United States, it has become essential to the endurance of the American auto industry and the dynamics of the global auto industry to make certain that China is not illegally subsidizing its manufacturers. In light of China's incomplete compliance with its WTO obligations since its accession to WTO in 2001, and in light of allegations of illegal subsidization, it would be prudent for the U.S. International Trade Commission, the WTO, and other pertinent governing bodies to scrutinize China's subsidization practices in the auto industry before China commences sales in the United States. Demanding Chinese compliance with the WTO would be in the best interest of industry leaders and especially the United States.

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259. Generally Accepted Accounting Principles, <http://en.wikipedia.org/wiki/GAAP> (last visited Feb. 23, 2009).

260. *Id.*