

The Runaway Trade Giant

Piracy, currency valuation, industry subsidies. As its impact on the U.S. economy expands, China is also growing less vulnerable to American pressure on key issues.

By BusinessWeek

Nucor ([NWE](#)) Chief Executive Daniel R. DiMicco sees a train wreck coming. True, Charlotte (N.C.)-based Nucor Corp., America's top steelmaker, had a banner year in 2005. But China now churns out more steel than the U.S., Japan, and Europe combined in mills that are "massively subsidized" by interest-free loans, an undervalued currency, and export tax breaks, he says. Despite its own voracious demand, China has become a net steel exporter. And more mills are in the pipeline. "If China decides to export significant amounts of steel," he warns, "there will be no such thing as competition."

DiMicco would love to see the U.S. file a complaint with the World Trade Organization to block a flood of Chinese imports. Trouble is, it's not clear that China's help to steel producers violates WTO rules. Besides, Washington does not want to bring cases it is unlikely to win. How about getting the Feds to file an anti-dumping suit in U.S. court? To succeed, Nucor would have to prove it was already damaged by cheap Chinese imports.

DiMicco's angst highlights a dilemma for Washington: No one quite knows what to do about a China that is growing into a trade giant but in many ways still plays by its own rules. True, China has liberalized greatly since entering the WTO in 2001. And it came bearing gifts on the eve of President Hu Jintao's trip to Washington. China has agreed to import U.S. beef and medical devices, load all PCs sold in the mainland with legal software, and buy \$16.2 billion worth of Boeing ([BA](#)) jets, Motorola ([MOT](#)) networking gear, and other goods. Another cause for cheer: America's February trade deficit with China shrank by 22.7% to its lowest monthly level in a year. The moves, declared Chinese Vice-Premier Wu Yi, show Beijing's intent to cut the trade gap and "observe the spirit of equality, mutual benefit, and win-win."

Yet worried execs like DiMicco see few signs of progress on the really big issues. They include China's refusal to significantly revalue its currency, its weak enforcement of rampant piracy, and its continued use of cheap credit, subsidies, and nontariff barriers to boost favored industries and companies. Besides being more aggressive in bringing antidumping suits and WTO cases when China violates the rules, U.S. officials say it's time for China to go beyond the agreements it made in 2001 and basically grow up. "We need a more balanced relationship," says U.S. Trade Representative Rob Portman, "based on the fact that China is a mature trading partner and a full-fledged WTO member."

Balancing the relationship, though, takes clout -- clout the U.S. may not have. The U.S. lost its ability to impose unilateral sanctions once China joined the WTO. Even if

America hauled China to Geneva on issues like currency, intellectual property rights, and industry policies, its chances of winning under WTO rules are slight.

U.S. efforts to get China to beef up enforcement of intellectual-property-rights laws are a case in point. For more than a decade, Washington has demanded that Beijing halt the piracy of software, music CDs, and movies. China's laws are fine, and it can crack down when it wants: Witness the scarcity of knockoffs of the mascot dolls for the Beijing Olympics.

But due to weak enforcement, trade groups claim U.S. software, entertainment, and publishing companies lose billions in China due to illegal copies. While Beijing announced a 14-point plan on Apr. 11 to crack down on pirates, skeptics say the U.S. shouldn't back off until it sees results. Says Dan Glickman, CEO of the Motion Picture Assn., which leads Hollywood's antipiracy fight: "On these issues where China really has not responded, I think the best leverage is the WTO."

Is it? Even if the U.S. does file a case alleging inadequate enforcement, there's no guarantee it will win. That's because the WTO lacks clear standards defining adequate progress toward enforcement, says China trade expert Nicholas R. Lardy of Washington's Institute for International Economics: "The elephant in the room nobody wants to talk about is that we don't have much leverage." If a suit fails, Beijing could ease the pressure on pirates. "To bring a case and lose it is detrimental," Portman says.

Another problem, U.S. trade officials complain, is that many U.S. software companies have been unwilling to gather and supply the hard data needed to mount a successful case. "Our bigger challenge isn't the law," says one official. "It's getting the evidence you need from companies who don't want to be seen as cooperating with the U.S. government." Besides risking retaliation against their mainland operations, executives aren't sure a successful WTO ruling will solve anything, given China's weak rule of law. "Even if you won, would it really change the way business is done at the provincial level, or change the business environment?" asks Heather Clark, assistant Asia vice-president of Pharmaceutical Research & Manufacturers of America.

The U.S. has been just as stymied in its efforts to force a revaluation of the yuan. American manufacturers claim the yuan is undervalued by as much as 40%, giving mainland exports a huge price edge. In response to Washington pressure, Beijing last year finally let the yuan fluctuate slightly, but it hasn't gained enough to make a big difference. A coalition of U.S. manufacturers and unions petitioned the USTR in 2005 to bring a WTO case charging China with manipulating its currency to boost exports. The USTR referred the issue to the U.S. Treasury Dept. It will soon issue a report on the topic to Congress, which could impose sanctions.

Yet Treasury is unlikely to brand China a manipulator. For one, many U.S. companies that produce in the mainland benefit from a cheap yuan. And if the U.S. imposed penalties, it may be on thin ice in the WTO. The trade body does not prohibit managed currencies. And while China has a huge trade surplus with the U.S., overall it imports

more than it exports to the rest of the world. So Washington won't get much backing in a showdown with Beijing. In reality, all Treasury can do is beg Beijing to change.

Good luck getting China Inc. to scrap its policy of boosting strategic industries, too. Perks like tax holidays, targeted loans, low-cost land, and government research and development subsidies don't necessarily violate WTO rules. Such help is proper, contends Wang Yong, director of Beijing University's Center for International Political Economy. For 20 years, China has given many breaks to lure multinationals, which now dominate markets for cars, cell phones, and other goods. "Keep in mind that the growth we've seen has been mainly driven by foreign-invested companies," Wang says, "while domestic companies have suffered a lot." Besides, subsidies that could be deemed unfair trade practices, such as free loans to steel or paper mills that export, are difficult to document due to weak government and company disclosure.

Aggrieved companies can always file antidumping suits in the U.S. against specific Chinese manufacturers that export at below-market prices. The U.S. slaps punitive duties on Chinese imports in dozens of cases each year. But the litigation is time-consuming and expensive, especially for small U.S. companies. "We've considered a dumping suit, but a lot of our members don't have the money and time," says Purchasing Manager Zachary J. Mottl of Lyons (Ill.)-based Atlas Tool & Die Works. Mottl is a director of a U.S. association of small manufacturers: Its membership has dropped from 1,600 to 1,200 in six years as many succumbed to super-cheap Chinese imports. "By the time they get a remedy, they already would be bankrupt."

What can be done to achieve radical change? "You will not litigate a country into changing its more important principles on how to run its economy," says a U.S. trade official. Washington can bring Beijing to the bargaining table with WTO threats, but progress will be slow. China the heavyweight will set the rules for some time to come.