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U.S.-Chinese Trade: Interface and Lawfare

Joel P. Trachtman



European University Institute  
**Robert Schuman Centre for Advanced Studies**  
Global Governance Programme

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## **Abstract**

This chapter offers a perspective on the legal aspects of U.S.-China trade relations, focusing on how the rise of China has challenged U.S. perspectives and principles. There are serious issues raised by the interface between China's state-controlled economy and the U.S. privately-controlled economy. The existing WTO legal rules are not well-designed to manage these issues, resulting in increasing U.S. dissatisfaction.

The Chinese economic and governmental structure is different from that of the U.S., and is not fully suited to the WTO free trade regime due to the extent of state control of the economy. In order to provide a level playing field for U.S. and Chinese enterprises, it will be necessary to develop new disciplines of transparency and neutrality in order to ensure that market-opening agreements are not nullified or impaired.

## **Keywords**

Trade, China, WTO, Dispute Settlement





## 1. Introduction\*

This chapter offers a perspective on the legal aspects of U.S.-China trade relations, focusing on how the rise of China has challenged U.S. perspectives and principles. There are serious issues raised by the interface between China's state-controlled economy and the U.S. privately-controlled economy. The existing WTO legal rules are not well-designed to manage these issues, resulting in increasing U.S. dissatisfaction.

The modern history of U.S.-China trade relations begins in 1971, with the re-establishment of diplomatic relations between the two countries. In 1971, the U.S. was the world's leading economy, and China was a largely agrarian society. While the U.S. soon became an important trading partner for China, this relationship was not economically significant to the U.S., with China accounting for only 2.2% of U.S. trade in 1990.<sup>1</sup> By the early 1990's, China had accelerated its economic liberalization, and begun its economic rise. U.S.-China trade relations were colored by U.S. human rights scrutiny beginning in 1974, with the implicit threat of imposition of punitive tariffs by the U.S. resulting in uncertainty regarding market access for Chinese goods in the U.S. One of China's major goals in entering the World Trade Organization was to obtain an international legal commitment from the U.S. to accord China unconditional most-favored nation (MFN) treatment. When China entered the WTO, its share of world trade was approximately 4%; by 2015, its share was 11.9%.<sup>2</sup>

The history of China's entry into the WTO in 2001, and of China-U.S. trade relations, carried out within the institutional structure of the WTO since 2001, and in bilateral fora like the U.S.-China Strategic & Economic Dialogue (SE&D) and the Joint Commission on Commerce and Trade (JCCT), has been a remarkable success in managing these trade relations for mutual benefit. These relations have managed a significant change in both countries' economies, with the rise of China as the world's leading manufacturer, and the restructuring of a number of industries in the U.S. While trade between China and the U.S. in the modern era has made both countries better off, it is also true that there has been economic dislocation on both sides of the Pacific. The average person and the average firm has benefited from growing trade,<sup>3</sup> but some firms and some individuals on both sides have seen their profits reduced or their livelihoods threatened.<sup>4</sup> However, trade restrictions are an inefficient way to protect or to compensate those firms and individuals.

And yet, on both sides of the Pacific, domestic political forces echoing a defunct mercantilist economic perspective<sup>5</sup> require that trade negotiators and litigators seek greater opportunities for protection from imports and promotion of exports. Conversely, domestic political forces seek reduction of trade barriers abroad, and, at least for producers, reduction of export promotion by the other state. Trade negotiations, forming law that may be the basis for subsequent litigation, are a way

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\* I am grateful to William Burke-White, Jacques DeLisle, Jeffrey Dunoff, Bernard Hoekman, Merit Janow, Chin Leng Lim, Petros Mavroidis, Tim Webster, and Mark Wu for extremely helpful comments on a preliminary version of this chapter. Errors are mine.

<sup>1</sup> Dong Wang, U.S.-China Trade, 1971–2012: Insights into the U.S.-China Relationship, *The Asia Pacific Journal*, June 16, 2013.

<sup>2</sup> World Trade Organization, "WTO Statistics: Tariffs," [https://www.wto.org/english/tratop\\_e/tariffs\\_e/tariff\\_data\\_e.htm](https://www.wto.org/english/tratop_e/tariffs_e/tariff_data_e.htm).

<sup>3</sup> See the calculations provided by Robert Lawrence, 'China's Rise and America's Welfare', in *China's Economic Transformation: Lessons, Impact and the Path Forward*, PIIE Briefing 15-3, October 2015. Lawrence's estimates, based on estimates of welfare losses due to job losses, and welfare benefits due to cheaper goods, show a benefit-cost ratio of U.S.-China trade equal to 6.2 between 1999 and 2011.

<sup>4</sup> See David Dollar, 'The Future of U.S.-China Trade Ties', October 4, 2016; David Autor, David Dorn, and Gordon Hanson, 'The China Shock', February 2016.

<sup>5</sup> John Maynard Keynes famously observed that "practical men who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist."

of managing these tensions, and of resolving them through reciprocal concessions. These reciprocal concessions seem to tend toward greater efficiency: toward agreements to remove barriers to trade. Trade law discourse and litigation, arguing about the application and meaning of existing trade law, is a way of managing these conflicts between protectionist political forces on both sides of the Pacific “in the shadow of the law.”

But at some junctures, and according to some attitudes, trade negotiations, discourse, and litigation, may seem like lawfare,<sup>6</sup> in the sense that China and the U.S. use law to enhance their individual shorter-term trade interests with lesser regard for long-term interests in maintenance of the system and for efficiency. More specifically, lawfare may include maximizing short term interests at the expense of systemic degradation, using legal rights for military or positional advantage, maintenance or propagation of illegal measures due to insufficient legal remedies, and retaliation against other countries’ exercise of legitimate rights.

It is not surprising that states engage in lawfare of this type in the trade context, and as in the military context, trade lawfare is generally to be preferred over trade warfare. Indeed, even lawfare is to be preferred over ballistic warfare. Nevertheless, trade lawfare is not supportive of the system, or of the long-term interests of either party. In this spirit, with respect to WTO litigation, Article 3.7 of the WTO Dispute Settlement Understanding stipulates that “before bringing a case, a Member shall exercise its judgement as to whether action under these procedures would be fruitful.”

At its core, national industrial policy, more obviously in China, but also in the U.S., is a critical role for the modern state, and states must reserve policy space in order to carry out their industrial policy. However, this industrial policy may be designed in a way that disproportionately, and unnecessarily, harms foreign interests. Trade negotiations often seem oriented toward causing states to take appropriate account of foreign interests as they determine their policies.<sup>7</sup>

Furthermore, regulation of products and of services and service providers is increasingly needed in order to protect consumers and to protect society from production and consumption externalities. Trade negotiations increasingly focus on ensuring that there is sufficient policy space to do so effectively, while also ensuring that these measures do not discriminate against or disproportionately harm foreign interests.

One of the most pressing economic problems facing China and the U.S. today is excess capacity in the steel, aluminum, ceramics, and other sectors. Much of China’s excess capacity is owned by its state-owned enterprises. Excess capacity is not itself a legal issue, but may arise due to subsidization, and it may give rise to anti-dumping, countervailing duty, and safeguard actions by trading partners seeking to protect their industries from the effects of excess capacity.

Finally, China and the U.S., as the world’s two leading powers, have the kind of tense friendship in which each must continue to ensure its security against possible encroachment from the other, while seeking to build trust through actions. In the WTO legal system, national security concerns provide the basis for exceptions from other WTO obligations. However, again, it is important to ensure that these concerns are not addressed through excessive restrictions on foreign interests.

The most important thing to say about China-U.S. trade relations is that they are exceedingly complex, engaging hundreds of different policy issues, and managed by specialists in these varying issues. So, in this brief chapter, I cannot address any of these issues in analytical depth. Rather, my goal is to provide a broader picture of conflict and cooperation in the field of trade law, and to suggest how this conflict and cooperation may continue to be managed for the mutual benefit of Chinese and

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<sup>6</sup> See Joel P. Trachtman, ‘Integrating Lawfare and Warfare’, *Boston College International and Comparative Law Review* 39:2 (2016) 267-282.

<sup>7</sup> See Joel P. Trachtman, ‘Open Economy Law’, in Jeffrey L. Dunoff and Mark A. Pollack (eds.) *Interdisciplinary Perspectives on International Law and International Relations* (Cambridge University Press 2013).

U.S. people. Moreover, this chapter was completed in December 2016, before the new U.S. administration implemented its trade policies. Much will change.

I will begin in Section 2 by describing briefly the legal history of Chinese-U.S. trade relations in the WTO era. Section 3 addresses the broad category of industrial policy conflicts, with subsections relating to discrimination, subsidies, dumping, export restrictions, exchange rate management, and state owned enterprises. I address conflicts based on security policy in Section 4.<sup>8</sup> In Section 5, I examine how U.S. and Chinese preferential trade agreement initiatives have sought to gain advantage in these areas—a kind of strategic forum shopping—recognizing that in 2017, the Trump administration backed away from earlier U.S. policy relating to preferential trade agreements. In Section 6, I conclude.

## **2. History of Chinese-U.S. Trade Relations in the WTO Era**

“Trade frictions are a statistical proportion of trade volumes, and trade disputes are a statistical proportion of trade frictions.” Pascal Lamy, then Director-General of the WTO, in 2012, referring to the U.S.-China trade relationship.<sup>9</sup>

China and the US have embraced very different economic models, but their economies are deeply intertwined. This combination of closeness and difference inevitably results in friction. While the differences have been reduced by China’s reforms, integration of these two major economies has steadily increased over many years. Generally speaking, the resulting friction has been managed effectively, despite important challenges at various points in time.

As an example, during the 20 years before China acceded to the World Trade Organization (WTO) in 2001, the U.S., through executive waivers, consistently accorded MFN tariff treatment to Chinese goods.<sup>10</sup> Since China’s accession to the WTO, China’s role in international trade has grown. There has been no trade war; rather, both sides have followed the rule of law process prescribed by the WTO for settling trade disputes.<sup>11</sup> China has been involved in many formal disputes with the U.S. and the E.U., especially since 2009. China has adhered to the WTO system faithfully, and has generally complied with adverse rulings.<sup>12</sup> The U.S. has generally done so as well. This is evidence of the pragmatic recognition that these two great powers’ destinies are joined, and that more is to be gained by sober management than by angry confrontation. This sober management is not to be taken for granted, especially during periods of economic downturn, when it is increasingly common for governments to scapegoat other countries for problems that are largely internal. More broadly, sober management implies adjustment of policy in response to changing circumstances.

As the late leader of U.S. trade law scholarship, John Jackson, pointed out, “in international economic relations, particularly in trade relations, some ‘interface mechanism’ may be necessary to allow different economic systems to trade together harmoniously.”<sup>13</sup> Jackson believed that the predecessor of the World Trade Organization, the GATT, served that purpose. It is difficult to think of

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<sup>8</sup> I do not address intellectual property issues, because these are distinct and complex enough to merit separate treatment.

<sup>9</sup> James Politi, ‘Lamy Dismisses Rise in U.S.-China Trade Disputes’, *Financial Times*, October 1, 2012.

<sup>10</sup> See Vladimir N. Pregelj, ‘The Jackson-Vanik Amendment: A Survey’, Congressional Research Service Report, August 1, 2005. The U.S. had suspended MFN treatment to China in 1951, and only restored it pursuant to bilateral agreement in 1980.

<sup>11</sup> See Ka Zeng, ‘High Stakes: United States Trade Disputes under the World Trade Organization’, *Asian Journal of Social Science* 41 (2013) 352–380. *But see* Timothy Webster, ‘Paper Compliance: How China Implements WTO Decisions’, *Michigan Journal of International Law* 35:3 (2014) 525–577.

<sup>12</sup> See Weihuan Zhou, Fifteen Years On: Has China Implemented WTO Rulings? *Asian Journal of WTO & International Health Law and Policy* 11:1 (2016) 155–212.

<sup>13</sup> John H. Jackson, *The World Trading System: Law and Policy of International Economic Relations* 218 (1989).

two economic systems more different than China and the U.S., and yet it is difficult to think of two economies more co-dependent than China and the U.S.<sup>14</sup> This leads to the question whether the WTO has sufficient institutional capacity to allow the China-U.S. relationship to be managed efficiently. Mark Wu argues that, although the U.S. and other trade partners tried to address the interface with China in the accession negotiations, subsequent important changes in the Chinese economy were not addressed.<sup>15</sup> There is much work to do in the future to manage these interface issues.

The legal aspects of trade relations between China and the U.S. are now largely governed by WTO law. China's accession to the WTO was negotiated over a period of nearly 15 years, with the U.S. the principal counterpart in the negotiations. China made substantial market access commitments in manufacturing, agricultural, and service sectors. Under China's Accession Protocol, China is treated differently and less favorably, compared to other WTO member states: China has "WTO-plus" responsibilities (which include what one might call "WTO-minus rights").<sup>16</sup> Some of this treatment reflects ways in which China's economic management has differed from that of other WTO members. For example, China is generally prohibited from imposing export duties,<sup>17</sup> while WTO law generally provides no such prohibition. However, other WTO members generally have not imposed export duties.

Another important way in which China was accorded "WTO-minus" rights was in terms of its treatment under antidumping and countervailing duty law. This is the infamous issue of "non-market economy" (NME) treatment, discussed below.

In addition, for the period through 2013, under the special safeguard mechanism provided by paragraph 16 of China's Accession Protocol, importing states were permitted to impose safeguard measures on imports from China that are "increasing rapidly" so as to be "a significant cause" of material injury to a domestic industry. This threshold is lower than that provided under normal WTO law.

Prior to China's accession to the WTO, the U.S. and other countries had great flexibility under international law to manage China's access to their markets. Once China acceded, this flexibility would be more constrained. So, the U.S. negotiated to relax some of these constraints through the WTO-plus aspects of China's Accession Protocol. As Hoekman and Kostecki recount, China was a "trade powerhouse . . . putting severe pressure on domestic industries [in existing WTO members] . . . Given the command nature of China's economy, many WTO members were only willing to accept China in the multilateral trading system if it could be shown that China's economy had become sufficiently market-based, with government intervention linked to what tends to be found in most countries."<sup>18</sup>

### 3. Management of Industrial Policy Conflicts

The most important "interface" issue involves the difference between China's state-led capitalism, and the U.S.' more laissez-faire capitalism. While the U.S. government engages in limited control over U.S. enterprises, largely through statute and regulation, the Chinese government exerts great direct, corporate, or informal control of Chinese enterprises, setting policy through the National Development

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<sup>14</sup> See generally, Wayne M. Morrison, 'China-U.S. Trade Issues', Congressional Research Service Report, December 15, 2015.

<sup>15</sup> Mark Wu, 'The "China Inc." Challenge to Global Trade Governance', 56 Harvard International Law Journal (forthcoming 2016).

<sup>16</sup> See Julia Ya Qin, "'WTO-Plus' Obligations and Their Implications for the World Trade Organization Legal System - An Appraisal of the China Accession Protocol', Journal of World Trade 37:3 (2003) 483-522.

<sup>17</sup> Accession Protocol, para. 11.

<sup>18</sup> Bernard Hoekman and Michel Kostecki, *The Political Economy of the World Trading System* 403 (Oxford 2001).

and Reform Commission (NDRC). For example, the Chinese State-Owned Assets Supervision and Administration Commission of the State Council (SASAC) controls the energy, steel, telecoms, and shipbuilding sectors, as well as a number of dominant companies in other sectors. The SASAC was formed in 2003. In addition, the Chinese government controls China's leading banks through Central Huijin Investment Ltd.

Wu points out that none of these structures had their present form before 2003.<sup>19</sup> In 2013, the U.S. Trade Representative (USTR) stated that “during most of the past decade, the Chinese government emphasized the state's role in the economy, diverging from the path of economic reform that had driven China's accession to the WTO.”<sup>20</sup>

China's extensive governmental involvement in its economy allows it to support domestic industries through explicit subsidies or through complex downstream subsidies, through financing decisions, or through decisions to purchase goods or services locally. Other tools include trade protection or discriminatory regulation, export restrictions, and domestic preferences in public procurement.

As a result of China's more extensive control of its economy, China's trade blocking measures are generally, although not exclusively, structured as internal discriminatory taxes, subsidies, or regulatory interventions. On the other hand, the U.S. measures that have blocked Chinese imports to the U.S. are largely, but not exclusively, structured as “at the border” measures, largely involving safeguards, anti-dumping duties and countervailing duties in relation to subsidies. The fact that in the recent past China has also begun to utilize this type of measure more frequently, as evidenced by WTO litigation brought by the U.S. in connection with three cases involving (i) grain-oriented flat-rolled electrical steel, (ii) broiler products, and (iii) automobiles, may be due to the fact that these “trade remedies” measures tend to provide greater flexibility for protection of domestic production.<sup>21</sup> Increasing use by China and other emerging market countries may lead to greater interest in reform of these trade remedies.

In WTO disputes, the U.S. often challenges Chinese governmental intervention in the Chinese economy through state-owned enterprises, subsidies, and other interventions, while China often challenges U.S. application of anti-dumping duties, countervailing duties, or safeguards (“trade remedies”). As of December 27, 2016, China had been complainant in 15 WTO cases, 10 of which were against the US. Nine of these 10 related to trade remedies actions by the U.S. The U.S., which was an original member of the WTO, had, at December 27, 2016, been complainant in 112 cases, 20 of which were against China. Five of these related to discrimination, four related to illegal export subsidies or import substitution subsidies, and three related to export restrictions or duties.

The U.S. has several times accused China of taking trade remedies or other actions against U.S. exporters to China as retaliation, or in order to increase leverage, in response to U.S. trade remedies actions against Chinese exporters.<sup>22</sup> This suggests a “lawfare”-type perspective, rather than a “rule of law”-type perspective, on trade. In other words, in these cases, China seems to see law as a weapon to be deployed more than as a source of objectively applicable rules that constitute a broadly and reciprocally beneficial system. A more public-spirited interpretation would suggest that China is playing a longer-term game, seeking to induce the U.S. to accept reforms of trade remedies laws.

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<sup>19</sup> Wu, *supra* note 15.

<sup>20</sup> United States Trade Representative, 2013 Report to Congress on China's WTO Compliance, December, 2013, at 2.

<sup>21</sup> See, Michael Finger, Francis Ng & Sonam Wangchuk, ‘Anti-Dumping as Safeguard Policy’, December 2001, available at <http://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-2730>.

<sup>22</sup> See United States Trade Representative, 2015 Report to Congress on China's WTO Compliance, December 2015, at 23 (“2015 USTR Report”).

This is not the place to be comprehensive. Nor is this the place to provide a complete analysis, “adjudicating” disputes over the violation of WTO law. Rather, my goal for this section is to provide an indicative sampling of the types of “interface” disputes that are important in China-U.S. trade relations.

### *a) Discrimination*

Industrial policy generally seeks to promote indigenous industries. This can be achieved by a variety of measures, but not all types of measures are permitted under WTO law. In some cases, China has used measures that have been adjudged, or in the case of measures that have not yet been adjudicated, alleged, to illegally discriminate against imported products. In one example of an adjudicated case, *China—Measures Affecting Imports of Automobile Parts*, the Panel and Appellate Body found that China’s measures effectively discriminated in tariff charges against the use of imported parts in automobiles.<sup>23</sup> China’s policy discouraged Chinese auto producers from using imported parts.

In 2010, the U.S. brought a discrimination case against China under the General Agreement on Trade in Services (GATS), relating to alleged discrimination against U.S. providers of electronic payment services. The panel found that China’s measures violated GATS obligations by requiring bank cards to bear the China UnionPay (CUP) logo, requiring issuers of payment cards to join the CUP network, and obligating all ATMs and point-of service terminals to accept CUP cards. China’s regulations establishing CUP as the exclusive provider for renminbi electronic payment services were also found to violate GATS.<sup>24</sup> In September 2016, the U.S. expressed dissatisfaction with China’s implementation of the panel report adopted in 2012.<sup>25</sup> A settlement agreement was reached in October 2016.

More recently, the U.S. has accused China of discrimination in connection with its exclusion of sales of certain aircraft produced in China from its value-added tax (VAT) while applying the tax to imported aircraft.<sup>26</sup> On December 8, 2015, the U.S. began consultations with China.<sup>27</sup> In October 2016, the U.S. announced that China had ended the tax exemptions for domestically-produced aircraft.<sup>28</sup> One of the U.S. complaints was that China provided these exemptions without sufficient transparency.

On the other hand, China accused the U.S. of discrimination in connection with Section 727 of the Omnibus Appropriations Act of 2009, which effectively blocked importation of Chinese poultry to the U.S. China successfully brought dispute settlement proceedings in which the panel determined that the U.S. measure violated the most-favored nation (MFN) obligations and prohibitions on quantitative restrictions in GATT, as well as relevant provisions of the Agreement on Sanitary and Phytosanitary Measures.<sup>29</sup> The U.S. approach in Section 727 was found to be overbroad and discriminatory. The U.S. motivation was not exclusively protectionist, but this case illustrates how health concerns may result in over-reaction, where the harm of over-reaction falls disproportionately on foreign persons.

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<sup>23</sup> Appellate Body Reports, *China—Measures Affecting Imports of Automobile Parts*, WT/DS339/AB/R / WT/DS340/AB/R / WT/DS342/AB/R, adopted 12 January 2009.

<sup>24</sup> Panel Report, *China—Certain Measures Affecting Electronic Payment Services*, WT/DS/413, adopted 31 August 2012.

<sup>25</sup> Statement by the U.S. at the Meeting of the WTO Dispute Settlement Body, Geneva, September 26, 2016.

<sup>26</sup> 2015 USTR Report, *supra* note 22, at 7.

<sup>27</sup> *China—Tax Measures on Domestically-Produced Aircraft*, DS501.

<sup>28</sup> Press Release, USTR, *China Ends Hidden, Discriminatory Tax Exemptions for Certain Chinese-Produced Aircraft*, October 2016, available at <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2016/october/china-ends-hidden-discriminatory>.

<sup>29</sup> Panel Report, *United States—Certain Measures Affecting Imports of Poultry from China*, WT/DS/392, adopted 25 October 2010.

On the other hand, the U.S. has expressed concerns over continuing Chinese barriers to U.S. beef, which were first imposed in 2003 in response to a case of mad cow disease in the U.S. This issue was raised in President Trump's first summit with President Xi in April 2017. Some have alleged that China's barriers have been maintained in retaliation for U.S. restrictions on imports of poultry products from China.<sup>30</sup>

#### ***b) Subsidies***

Subsidies are the most common form of industrial policy intervention. Export and import substitution subsidies are illegal under WTO law, but other subsidies are generally permitted, although they may be actionable or countervailable under certain circumstances. The U.S. has challenged a number of China's subsidies programs. These challenges have been framed in terms of violations of WTO law. In addition, the U.S. has used the authority provided under WTO law to apply countervailing duties in response to exports to the U.S. of goods benefiting from permitted subsidies.

Another example of settlement negotiations in the shadow of WTO law is the Chinese "Demonstration Bases-Common Service Platform" program, which provided free or discounted services to enterprises in certain sectors. Access to this program included export-contingent criteria. The U.S. filed a WTO complaint in February 2015, alleging that this program violated the WTO prohibition of export subsidies, and a panel was formed in April 2015. However, negotiations continued and the parties reached an agreement on April 14, 2016 by which China would withdraw the measures that the U.S. identified as violating WTO law.<sup>31</sup>

Between 1979 and 2006, the U.S. did not apply its countervailing duty law to Chinese imports, because of China's non-market economy (NME) status. But in 2007, the Department of Commerce (DoC) reversed its position that it would not carry out countervailing duty determinations for NMEs. Since then, China has been an important target of U.S. countervailing duties. The DoC position was reversed in domestic litigation, and then reinstated by U.S. statute in 2012.

In a 2011 WTO case, China challenged the U.S. "use of its NME (non-market economy) methodology in the four anti-dumping investigations at issue and the imposition of anti-dumping duties on that basis concurrently with the imposition of countervailing duties on the same products in the four countervailing duty investigations at issue" (i.e., imposing "double remedies").<sup>32</sup> The concern is that the subsidization is countervailed, but that it also has a price effect in connection with an input price-based constructed normal value, reflected in the dumping margin, with the result that the same subsidization is subject to both a countervailing duty and an anti-dumping duty: a "double remedy" for subsidization. The price effect arises from the fact that the dumping margin calculated using the NME methodology reflects "'economic distortions that affect the producer's costs of production,' including specific subsidies to the investigated producer." As a result, "[a]n anti-dumping duty calculated based on an NME methodology may, therefore, 'remedy' or 'offset' a domestic subsidy, to the extent that such subsidy has contributed to a lowering of the export price."<sup>33</sup>

The Appellate Body thus found that "an appropriate amount of countervailing duty [under Article 19.3 of the SCM Agreement] should be an amount that results in offsetting subsidization, with due regard being had to the concurrent application of anti-dumping duties on the same product that offset the same subsidization."<sup>34</sup>

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<sup>30</sup> See Bruce Einhorn, Why China's Got Beef with U.S. Beef, Bloomberg Politics, April 5, 2017.

<sup>31</sup> China — Measures Related to Demonstration Bases and Common Service Platforms Programmes, DS489.

<sup>32</sup> Appellate Body Report, United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China, WT/DS379/AB/R, adopted 25 March 2011, para. 539.

<sup>33</sup> *Id.*, paras. 541-543.

<sup>34</sup> *Id.*, para. 575.

### c) *Dumping*

Like countervailing duty law, permission for importing countries to levy anti-dumping duties seems to allow countries to respond to a practice that does not generally cause bad effects to the importing state's economy. Predatory pricing is rarely successful, raising questions about the rationale for anti-dumping law. Furthermore, anti-dumping law as presently formulated in the WTO and in U.S. law, and in Chinese law, is subject to possible overbreadth in that it may apply even where its purported policy goals of defending against predatory pricing are not implicated, unnecessarily restricting trade. The U.S. is an active user and defender of anti-dumping actions, and China has challenged U.S. determinations several times.

But even beyond the normal problems that trade partners experience with U.S. anti-dumping law, China is subject to a special NME regime. Under Article 15(a)(ii) of China's Protocol of Accession to the WTO,

The importing WTO Member may use a methodology that is not based on a strict comparison with domestic prices or costs in China if the producers under investigation cannot clearly show that market economy conditions prevail in the industry producing the like product with regard to manufacture, production and sale of that product.

This provision, which expired on December 11, 2016, placed the burden of proof on the producers under investigation to show that market economy conditions prevail in their industry, and that therefore, Chinese prices can be used for comparison in determining dumping. On December 12, 2016, China began WTO dispute settlement against the U.S. (and E.U.) application of NME methodology in anti-dumping cases.<sup>35</sup> The question raised by the dispute is whether the expiry of Article 15(a)(ii) means that Chinese enterprises are conclusively entitled to market economy status, or whether they remain subject to a determination of market economy status by the administering authority of the importing state—in the case of the U.S., the Department of Commerce.

If the U.S. continues to classify China as a NME, it can disregard Chinese prices and costs and instead use external benchmarks, such as those of a third country, to calculate dumping margins. This practice has generally led to significantly higher anti-dumping duties. U.S. manufacturers have begun lobbying for continued NME treatment for China. For example, a U.S. coalition of manufacturing industry associations, "Manufacturers for Trade Enforcement," has argued that "state support of domestic manufacturing in China has distorted global markets, leading to significant oversupply and other issues that are hurting domestic manufacturers."<sup>36</sup> The U.S. appears to take the position that China does not qualify for market economy status, particularly in the steel and aluminum sectors.<sup>37</sup> On April 3, 2017, the U.S. Department of Commerce announced that it is reviewing China's NME status.<sup>38</sup>

Recall that the U.S. expected greater reform to take place in China after China's accession to the WTO, and perhaps the expiration of Article 15(a)(ii) was timed to take place after China's economy had become more market-oriented.

In its EC—Fasteners decision, the Appellate Body offered some comments on this provision in *dictum*, stating that paragraph 15(a) contains "special rules for the determination of normal value in anti-dumping investigations involving China," while "Paragraph 15(d) in turn establishes that these

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<sup>35</sup> United States—Measures Relating to Price Comparison Methodologies, WT/DS515/1, December 15, 2016.

<sup>36</sup> Press Release, Manufacturers for Trade Enforcement, 'Coalition of U.S. Manufacturers Calls on Department of Commerce to Fairly Assess China's Economic Status', March 16, 2016.

<sup>37</sup> Tom Miles, 'U.S., China Clash Over Market Economy Status at WTO', Reuters, July 15, 2016.

<sup>38</sup> International Trade Administration, Certain Aluminum Foil From the People's Republic of China: Notice of Initiation of Inquiry Into the Status of the People's Republic of China as a Nonmarket Economy Country Under the Antidumping and Countervailing Duty Laws, 82 FR 16162, April 3, 2017.



special rules will expire in 2016 . . . ."<sup>39</sup> Paragraph 15(a)(ii) allocated a burden of proof to Chinese producers, while Paragraph 15(d) eliminates that allocation. Thus, NME status for China will be determined after December 11, 2016, in the same way that it is determined for other WTO members. The burden of proof shifts back from China to the importing state to show that NME treatment is appropriate under the Ad Note to Art. VI:1 of GATT and under Art. 2.2 of the Anti-Dumping Agreement.

In the EC—Fasteners decision, however, the Appellate Body suggested that the test under the Ad Note to Art. VI:1 sets a high threshold for control by the state:

We observe that the second Ad Note to Article VI:1 refers to a "country which has a complete or substantially complete monopoly of its trade" and "where all domestic prices are fixed by the State". This appears to describe a certain type of NME, where the State monopolizes trade and sets all domestic prices. The second Ad Note to Article VI:1 would thus not on its face be applicable to lesser forms of NMEs that do not fulfil both conditions, that is, the complete or substantially complete monopoly of trade and the fixing of all prices by the State.<sup>40</sup>

The purported goal of anti-dumping duties is to reduce the impact of artificially low pricing on exported goods. It is difficult to determine what constitutes "artificially low" without a market benchmark. Assuming that an anti-dumping regime is desired, the treatment accorded China should be carefully designed to address the special nature of the Chinese economy, without further disadvantaging China. However, the control exercised by the Chinese government suggests that domestic prices are not set by market forces, and thus may not provide an appropriate market benchmark.

This is an important interface issue, because at the core of this issue is whether China may be subjected to worse treatment than other countries in calculating anti-dumping duties, because domestic prices and costs may be set bureaucratically at artificially low levels, resulting in lower anti-dumping duties than would apply if these prices and costs are set by market forces. This is an instance in which a special regime applied to China would continue to make sense, and the high threshold of the second Ad Note to Article VI:1 may not provide sufficient nuance.

#### ***d) Export Restrictions***

In recent years, China has restricted or imposed duties on exports of certain raw materials, including rare earths. China had important industrial policy reasons for doing so. By restricting exports, domestic producers are ensured more plentiful supply, at lower prices. The United States and other countries challenged China's restrictions at the WTO as illegal restrictions on trade, and so far have been successful in inducing China to eliminate its restrictions. WTO law has evolved a nuanced mechanism for dealing with national measures that may have multiple purposes.

For example, the rare earths case addressed claims against China's export duties and export restrictions on rare earths, tungsten, and molybdenum.<sup>41</sup> China is the dominant producer of rare earths, providing approximately 97% of the world supply, although these elements exist in many other countries, including the U.S. Mining and processing activities present environmental and health risks. "Rare earth deposits often contain radioactive elements, which means separating the metals requires costly and strenuous processes that produce a number of toxic pollutants and hazardous waste

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<sup>39</sup> Appellate Body Report, European Communities – Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China, WT/DS397/AB/R, adopted 28 July 2011, para. 285.

<sup>40</sup> *Id.*, para. 460.

<sup>41</sup> "Rare earths" includes a group of 17 elements with special properties of magnetism, luminescence and strength, important in the production of high tech products, including weapons systems and clean energy products.

material.”<sup>42</sup> In other words, rare earth production causes serious production externalities. There may also be military motivations, because some rare earths are important to high tech military equipment.

Between 2005 and 2010, Chinese export quotas on rare earths were cut by more than 50%, resulting in a more than seven-fold increase in world prices. In light of the importance of these products for national security and environmental applications, these price increases generated substantial public concern in the US, Japan, and European Union. In the U.S., 14 bills were introduced in Congress to address the availability of rare earths.

The China—Rare Earths decision of the Appellate Body<sup>43</sup> addressed two main issues: (i) whether China’s obligations not to impose export duties under its accession protocol are subject to exceptions under Article XX of GATT, and (ii) the scope of the exception for China’s export quota measures relating to conservation under Article XX(g) of GATT. In accord with its China—Raw Materials decision,<sup>44</sup> the Appellate Body found that there is no textual basis for application of the Article XX exception to China’s export duty obligations, because the relevant part of the accession protocol does not explicitly incorporate the GATT exceptions. This interpretation exalted a narrow contextual approach over an approach to interpretation that would focus on broader context, object, and purpose, and it reinforced concerns that China is inappropriately accorded “WTO-plus” responsibilities.<sup>45</sup> The Appellate Body also approved the Panel’s overall approach to determining the availability of the Article XX(g) exception. This approach focused on the design and structure of China’s quota measure, but left unresolved important issues, including the extent to which non-conservation purposes may prevent use of the exception and the role of empirical evidence of effects in these determinations.

On 13 July 2016, the United States requested consultations regarding China’s export duties on antimony, cobalt, copper, graphite, lead, magnesia, talc, tantalum, and tin, arguing that these export duties violate Article 11.3 of China’s WTO Accession Protocol.<sup>46</sup> The WTO established a panel to hear this case on November 8, 2016. This case echoes the earlier cases regarding export duties and other export restrictions on various raw materials, and on rare earth materials.

This series of cases, similar on the other side to the challenges to U.S. zeroing policy, suggests a willingness to continue actions that are likely to be found illegal under WTO law, in order to achieve economic goals in the interim. This approach of using the fact that WTO dispute settlement decisions can take several years, only decide the particular case, and provide only prospective remedies, might be understood as a type of lawfare, in the sense that lawfare includes actions known to be unlawful but taken where the remedies for violation are insufficiently compelling.

### *e) Exchange Rates*

The U.S. has argued that China has improperly intervened in money markets in order artificially to suppress the value of the renminbi. Although China has intervened to suppress the value of the renminbi from 2000 to 2014,<sup>47</sup> it does not appear to have done so in recent years. In April 2017, the

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<sup>42</sup> Wayne M. Morrison & Rachel Tang, ‘China’s Rare Earth Industry and Export Regime: Economic and Trade Implications for the United States’, Congressional Research Service Report (2012).

<sup>43</sup> Appellate Body Reports, China – Measures Related to the Exportation of Rare Earths, Tungsten, and Molybdenum, WT/DS431/AB/R / WT/DS432/AB/R / WT/DS433/AB/R, adopted 29 August 2014.

<sup>44</sup> Appellate Body Reports, China – Measures Related to the Exportation of Various Raw Materials, WT/DS394/AB/R / WT/DS395/AB/R / WT/DS398/AB/R, adopted 22 February 2012.

<sup>45</sup> Eric Bond & Joel P. Trachtman, ‘China–Rare Earths: Export Restrictions and The Limits of Textual Interpretation’, *World Trade Review* 15:2 (2016) 189-210.

<sup>46</sup> China—Export Duties on Certain Raw Materials, DS508.

<sup>47</sup> Eduardo Porter, Trump Isn’t Wrong on China Currency Manipulation, Just Late, *New York Times*, April 11, 2017.

U.S. Treasury declined to label China a “currency manipulator,” despite promises by President Trump when he was a candidate to do so.

Moreover, while some argue that the Chinese currency is now over-valued, Staiger and Sykes conclude that the extent of any currency misalignment is difficult to measure, and its effects on trade are difficult to ascertain.<sup>48</sup> This point will result in difficult evidentiary problems in connection with any claim against China under WTO law. Furthermore, there are serious questions as to whether these types of exchange rate management are prohibited or actionable subsidies under WTO law, and whether WTO law contains a relevant restriction on exchange rate practices.<sup>49</sup> As this chapter was written, the U.S. had so far not characterized China’s exchange rate practices as actionable subsidies, and had not acted unilaterally or brought a WTO case to address China’s exchange rate practices. This status could change due to political pressure, but it is highly uncertain whether the relevant exchange rate practices would be considered actionable subsidies under WTO law.

#### ***f) State-Owned Enterprises and Government Procurement***

State-owned enterprises (SOEs) raise difficult issues in connection with anti-dumping, subsidies, state trading, and government procurement. China’s economy is still dominated by SOEs, although reform of SOEs seems to be a priority for the Xi Jinping administration.

This issue came to the fore in United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China (“*Certain Products from China*”).<sup>50</sup> The central question was which Chinese entities were included within the term “public body” in Article 1.1(a)(1) of the SCM Agreement. Article 1.1(a) of the SCM Agreement provides that a “subsidy” exists if there is a “financial contribution by a government or any public body” and “a benefit is thereby conferred.” The United States urged the Appellate Body to uphold the Panel’s finding that “public body” in the sense of Article 1.1(a)(1) means any entity controlled by a government, which would include all SOEs.<sup>51</sup> China, on the other hand, argued that a public body is limited to an entity that exercises authority vested in it by the government for the purpose of performing functions of a governmental character.<sup>52</sup> Thus, under the Chinese interpretation, SOEs that do not perform governmental functions would be excluded.

The Appellate Body determined that “the performance of governmental functions, or the fact of being vested with, and exercising, the authority to perform such functions are core commonalities between government and public body.”<sup>53</sup> “A public body within the meaning of Article 1.1.(a)(1) of the SCM Agreement must be an entity that possesses, exercises or is vested with governmental authority.”<sup>54</sup> Ownership and control are not sufficient to constitute an entity a public body. Thus, not all SOEs would constitute public bodies for purposes of this definition. The Appellate Body essentially accepted the Chinese argument.

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<sup>48</sup> Robert Staiger & Alan Sykes, *Currency Manipulation in World Trade*, NBER Working Paper No. 14600 (2009).

<sup>49</sup> Joel P. Trachtman, *Yuan to Fight About It? The WTO Legality of China’s Exchange Regime*, Voxeu 2010.

<sup>50</sup> Appellate Body Report, *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R, adopted 25 March 2011.

<sup>51</sup> *Id.*, para. 280.

<sup>52</sup> *Id.*, para. 279.

<sup>53</sup> *Id.*, para. 290.

<sup>54</sup> *Id.*, para. 317.

The Appellate Body's determination in *Certain Products from China*, combined with its later decision in *U.S.—Countervailing Duties on Hot Rolled Steel from India*,<sup>55</sup> left the possibility that SOEs would not be considered public bodies, but that they might operate in a way that does not follow commercial considerations, disadvantaging imports or advantaging exports. In connection with Trans-Pacific Partnership (TPP) negotiations, the U.S. articulated the following goals with respect to SOEs:

- Commitments ensuring SOEs act in accordance with commercial considerations and compete fairly, without undue advantages from the governments that own them, while allowing governments to provide support to SOEs that provide public services domestically; and
- Rules that will provide transparency with respect to the nature of government control over and support for SOEs.<sup>56</sup>

Indeed, the final TPP text includes a definition of SOE that is based on 50% or greater ownership or voting control—essentially the definition of “public body” that the U.S. argued for in *Certain Products from China*.<sup>57</sup> The obligations contained in the TPP would achieve the above goals.

For U.S.-China relations, this is a critical “interface” issue, because China intervenes far more extensively in its economy, through SOEs and through other mechanisms, than does the U.S. Thus, Chinese SOEs that do not otherwise perform public functions may be used as tools of industrial policy, favoring domestic production and disfavoring imported production, with little potential discipline under the WTO subsidies regime.

China has not yet acceded to the WTO Government Procurement Agreement (GPA), and therefore has few obligations regarding government procurement. Chinese accession to the GPA is a major U.S. government priority, especially in light of the magnitude of China's government procurement budget.

#### 4. Regulatory Trust and Management of Trade-Related Security Conflicts

China and the U.S. are engaged in a degree of security competition, but this competition is at this point not viewed as existential, as the Cold War was. Therefore, there is more for both sides to gain by cooperation that enriches both partners, and it is important to ensure that security concerns do not excessively impede trade. In order to do so, China and the U.S. should promote transparency in manufacturing processes and software design as much as possible. The U.S. is concerned about the Chinese government's control of Chinese SOEs and other Chinese enterprises otherwise under the influence of the Chinese government, and the possibility that products or services may present security concerns. Although the U.S. exercises less control and influence over its enterprises, China also has concerns. These concerns should be addressed in a way that promotes trade and investment.

In recent bilateral negotiations, China and the U.S. have discussed issues of cybersecurity that arise in connection with commercial imports of information and communications technology (ICT).<sup>58</sup> Pursuant to those negotiations, China was willing to commit that its cybersecurity measures would be consistent with WTO law, would be narrowly tailored, would take into account international standards, and would be non-discriminatory. At the November 2015 JCCT meeting, China committed that new information security measures will not unnecessarily restrict commercial sales opportunities for foreign suppliers of ICT products and services.<sup>59</sup>

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<sup>55</sup> Appellate Body Report, United States – Countervailing Measures on Certain Hot-Rolled Carbon Steel Flat Products from India, WT/DS436/AB/R, adopted 19 December 2014.

<sup>56</sup> United States Trade Representative, Trans-Pacific Partnership, Summary of U.S. Objectives (undated).

<sup>57</sup> Trans-Pacific Partnership, Art. 17.1.

<sup>58</sup> 2015 USTR Report, at 5.

<sup>59</sup> 2015 USTR Report, at 78.

## 5. Preferential Trade Agreement Initiatives

With the disappointing outcome of the Doha Round of WTO trade negotiations, governments have moved toward preferential trade agreements. In the U.S., some of these preferential trade agreements have met with new and forceful political opposition. Nevertheless, President Obama pursued negotiations and signed the TPP, subject to ratification pursuant to a vote of Congress, and continued negotiations for the TTIP. President Trump withdrew the U.S. from TPP in early 2017. However, some have argued that TPP contains some of the modern improvements that might be sought in renegotiation of the North American Free Trade Agreement.

BRICS like China were not proposed to be included in these initiatives, although it is possible that China would eventually join the TPP. Former U.S. Commerce Secretary Penny Pritzker observed that “TPP is open architecture, and TPP is really meant to be about setting high standards for trade — standards that aspire to be equivalent to the United States.”<sup>60</sup> In a 2014 study,<sup>61</sup> Peter Petri and Michael Plummer, and Fan Zhai of China Investment Corp., estimated that if China *joins* TPP, China would realize income gains of \$809 billion by 2025. If it does not, China would lose over \$46 billion by 2025. A more recent study by Petri and Plummer shows more modest losses of \$18 billion a year by 2030 (0.1 percent of its GDP).<sup>62</sup> These magnitudes of loss are small relative to China’s GDP.

Thus, if the U.S. joins TPP and China does not, these initiatives may present a modest challenge to China, which has benefited from MFN market access under the WTO. On the other hand, given complex modern production and long supply chains, even if China does not join, TPP could *increase* Chinese market access in major markets like the U.S. and Japan, so long as the final products are understood under rules of origin to originate in TPP countries. For similar reasons, China may also benefit from investment in plants in TPP member countries.

For its part, China has led formation of the Regional Comprehensive Economic Partnership (RCEP). Much of the membership of RCEP is expected to overlap with the proposed membership of TPP. RCEP is proposed to include the 10 ASEAN states plus six states with which ASEAN has trade agreements: Australia, China, India, Japan, New Zealand, and South Korea.

Following are the members of TPP and RCEP, with overlapping members presented in **bold**.

TPP: **Australia, Brunei**, Canada, Chile, **Japan, Malaysia**, Mexico, **New Zealand**, Peru, **Singapore**, [United States], and **Vietnam**

RCEP: **Australia, Brunei**, Burma (Myanmar), Cambodia, China, India, Indonesia, **Japan**, Laos, **Malaysia, New Zealand**, the Philippines, **Singapore**, South Korea, Thailand, and **Vietnam**

President Obama stated that the TPP, and presumably the TTIP as well, are designed to allow the U.S. to play a leading role in “writing the rules” for global trade, instead of China.<sup>63</sup>

There are a number of ways in which the U.S. under Obama used negotiations in the smaller TPP forum in order to propose rules among the TPP member countries that are favorable to the U.S., in order to expand the international coalition in favor of those rules for future regional or multilateral negotiations. This strategy is evident in areas such as exchange rate policy, state-owned enterprises, environmental and labor protection, and intellectual property. For example, the U.S. sought assurances regarding currency manipulation in connection with the TPP. However, it was only able to achieve a non-binding declaration that is not included in the treaty itself. Otherwise, there seems to be little that

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<sup>60</sup> Keith Bradsher, ‘Once Concerned, China is Quiet About Trans-Pacific Trade Deal’, New York Times, April 28, 2015.

<sup>61</sup> Peter Petri, Michael Plummer, and Fan Zhai, ‘The TPP, China and the FTAAP: The Case for Convergence’, May 19, 2014.

<sup>62</sup> Peter Petri and Michael Plummer, ‘Economics of the Trans-Pacific Partnership’, 30 April 2016.

<sup>63</sup> Statement by the President on the Trans-Pacific Partnership, October 5, 2015.

is truly competitive between the TPP and RCEP.<sup>64</sup> For example, if Vietnam accepts labor protection requirements under TPP, this labor protection is not diluted by RCEP. Moreover, Vietnam might be interested in extending labor requirements under RCEP, or even in a revived WTO negotiation, in order to ensure that competitors like Indonesia are subject to similar requirements.

## **6. Moving Forward: Managing Trade Conflicts Within and Outside the WTO**

This chapter has suggested a number of areas in which China and the U.S. have successfully managed a complex trade relationship through international law. This concluding section suggests some ways in which China and the U.S. may continue managing this mutually beneficial relationship.

### ***a) Avoid Defunct Economics***

Both U.S. and Chinese politicians and trade officials think of trade in “defensive”—protect from imports—and “offensive”—promote exports—terms. These mercantilist perspectives oversimplify and fail to reflect the benefits of trade as both importer and exporter of goods and services. Another form of defunct economics is to utilize trade protection as a substitute for adjustment assistance. International trade relations can be better managed by national governments if they avoid blaming trade for economic dislocation caused by technological change and other factors, and if they provide appropriate adjustment assistance, including retraining and financial support, for those whose livelihoods are impaired.

### ***b) Manage Interface Issues Reciprocally in the Spirit of Free Trade***

The Chinese economic and governmental structure is different from that of the U.S., and is not fully suited to the WTO free trade regime due to the extent of state control of the economy. In order to provide a level playing field for U.S. and Chinese enterprises, it will be necessary to develop new disciplines of transparency and neutrality in order to ensure that market-opening agreements are not nullified or impaired. The spirit of free trade, which benefits both states, will require China to accept special arrangements to do so. This is not the China of the unequal treaties period, but a China that can assert itself while recognizing that it must accommodate in order to interface equally with market economies. It will also require the U.S. to structure its domestic trade law system, including its treatment of SOEs and NMEs, so as to ensure that its market-opening commitments to China are not inappropriately impaired. This should not be viewed as a struggle to open export markets while protecting the home market. Rather, both sides benefit from opening both markets without unnecessarily impairing each state’s ability to have the type of economy that it desires. This is the management of interface.

### ***c) Avoid Destructive Regionalism***

Regionalism such as the TPP and RCEP can provide both static and dynamic benefits in terms of increased welfare due to trade and promotion of multilateral liberalization. However, they can also cause static and dynamic detriments, by diverting trade from the most efficient producers and by undermining multilateral liberalization. These regional agreements, as a technique of variable geometry, should be structured so as to be open to new members and overlapping memberships, and their benefits, so far as possible, should be offered on a multilateral MFN basis.

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<sup>64</sup> Simon Lester, ‘Chinese Free Trade is No Threat to American Free Trade’, Cato Institute, April 22, 2015.

***d) Lawfare and the Rule of Law in Trade***

International law can be used in two ways. First, it can be used to promote short-term national advantage in particular disputes. Second, it can be used to support rules that benefit all, with the expectation that over the long term, this will best promote national advantage. China and the U.S. can lead the world in formulating and using WTO law. If they both engage in long-term support of beneficial trade rules, they will both prosper more in the long run.

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