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Trade Policy Priority One: Averting a U.S.-China "Trade War"

by Daniel Ikenson

Introduction

An emerging narrative in 2012 is that a proliferation of protectionist, treaty-violating, or otherwise illiberal Chinese policies is to blame for worsening U.S.-China relations. China trade experts from across the ideological and political spectra have lent credibility to that story. Business groups that once counseled against U.S. government actions that might be perceived by the Chinese as provocative have changed their tunes. The term "trade war" is no longer taboo.

The media have portrayed the United States as a victim of underhanded Chinese practices, including currency manipulation, dumping, subsidization, intellectual property theft, forced technology transfer, discriminatory "indigenous innovation" policies, export restrictions, industrial espionage, and other ad hoc impediments to U.S. investment and exports.

Indeed, it is beyond doubt that certain Chinese policies have been provocative, discriminatory, protectionist, and, in some cases, violative of the agreed rules of international trade. But there is more to the story than that. U.S. policies, politics, and attitudes have contributed to rising tensions, as have rabble-rousing politicians and a confrontation-thirsty media. If the public's passions are going to be inflamed with talk of a trade war, prudence demands that the war's nature be properly characterized and its causes identified and accurately depicted.

Those agitating for tough policy actions should put down their battle bugles and consider that trade wars are never won. Instead, such wars claim victims indiscriminately and leave significant damage in their wake. Even if one concludes that China's list of offenses is collectively more egregious than that of the United States, the most sensible course of action—for the American public (if not campaigning politicians)—is one that avoids mutually destructive actions and finds measures to reduce frictions with China.

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Nature of the U.S.-China Trade War

It should not be surprising that the increasing number of commercial exchanges between entities in the world's largest and second largest economies produce frictions on occasion. But the U.S.-China economic relationship has not descended into an existential call to arms. Rather, both governments have taken protectionist actions that are legally defensible or plausibly justifiable within the rules of global trade. That is not to say that those measures have been advisable or that they would withstand closer legal scrutiny, but to make the distinction that, unlike the free-for-all that erupted in the 1930s, these trade "skirmishes" have been prosecuted in a manner that speaks to a mutual recognition of the primacy of—if not respect for—the rules-based system of trade. And that suggests that the kerfuffle is containable and the recent trend reversible.[1]

Still that relatively benign characterization does not mean there is no cause for concern. Protectionist actions—whether part of a series of events dubbed a trade war or not; whether within the rules of trade or not—impinge on our freedoms, increase costs of living, drive up production costs for businesses, reduce employment, retard more efficient resource allocations, and produce economic losses in both countries (and beyond). This is a fact dangerously obscured by gung-ho media pundits and politicians who hoist their flags and cast trade disputes in a terribly misleading "us-versus-them" context, implying along the way that domestic costs are borne only of inaction.

Ratcheting up Tensions

The year 2009 brought a change in tenor to the U.S.-China relationship. The rhetoric became more strident, historically minor tiffs became flashpoints, and the public's

angst became more palpable. What was going on in 2009 that might provide some insights?

First, the U.S. economy was immersed in a deep recession, while the Chinese economy was continuing its near-double-digit annualized growth. That juxtaposition sparked some public soul-searching among pundits and policymakers, many of whom questioned whether America's best days were behind her, with some concluding that U.S. policy had been too permissive of China's rise. In the United States that discussion begat calls for greater trade enforcement (which to some meant tighter restrictions regardless of the rules) and emulation of China's allegedly successful industrial policies. In China, meanwhile, the emerging perceptions emboldened leaders to dig in their heels over issues where they might have relented in the past. Sentiment clearly had been agitated by economic conditions and the perceptions they bore.[2]

Second, and more substantively, the U.S. business community in China, which had long counseled against U.S. policies that might frustrate its access to the Chinese market, began to air grievances about proliferating Chinese protectionism and issued warnings that China's market liberalization—evident through the early part of the last decade—had stopped and was beginning to reverse. An annual white paper published by the American Chamber of Commerce in China identified rising protectionism, lack of regulatory transparency and consistency, and favoritism toward local firms as big and growing problems in 2009.[3] Meanwhile, another report published by AmCham-China exposed "a web of industrial policies" in China, such as indigenous innovation policies and elaborate plans to build national champions by borrowing Western technology.[4]

Publication of those reports and reaction to them inspired a change in sentiment within the U.S. multinational community, which shifted the balance of interests that shape U.S.–China policy in the direction of those traditionally more inclined toward trade restrictions and tougher enforcement, giving greater cover to U.S. policymakers to take a more strident tack with Beijing.

And third, in September 2009, President Obama authorized the imposition of duties on imports of certain Chinese tires pursuant to Section 421 of the Trade Act of 1974.[5] The president's decision crossed a line for the Chinese, since that statute had never before resulted in the imposition of duties.

Section 421 (or the "China-specific safeguard") became U.S. law as a term of China's accession to the World Trade Organization (WTO) in December 2001. Among many other concessions made by China to overcome special interest opposition to its joining the WTO was China's consent to allow the United States (and other WTO members) recourse to a so-called safeguard mechanism. Imposition of duties was conditioned upon there being an increase in imports in such increased quantities as to be a cause or threat of "market disruption" to domestic producers. But given this low evidentiary threshold—when does credible competition not cause market disruption?—the president was granted discretion to reject duties if "provision of such relief is not in the national economic interest of the United States or, in extraordinary cases, that the taking of action . . . would cause serious harm to the national security of the United States."

On the four occasions when the U.S. International Trade Commission recommended to former president George W. Bush that he impose duties under Section 421, he rejected the recommendations on the grounds that duties were not in the national economic interest. Thus, precedent had been established that presidential discretion, exercised with the national interest in mind, could prevent the imposition of duties in these cases.

So, when President Obama authorized the duties on tires (his first and only bite at the 421 apple), it was the first time a U.S. president personally signed off on a protectionist measure against China.[6] That his decision came after months of deliberating the costs and benefits and ramifications for the bilateral relationship, and was characterized by the president as "enforcement" of U.S. trade laws, was perceived as an insult—even a provocation—in Beijing. Section 421 is clearly not about enforcement. Duties imposed under that statute are about industry winning a temporary reprieve from foreign competition so that it can catch its breath and, perhaps, compete more effectively in the future. Foreign behavior—whether pricing practices, subsidies, or some other castigated practice—is not at issue in 421 cases. Consideration of any wrongdoing is entirely absent from the proceedings. Rather than "enforce," the U.S. government "exercised its conditional right" to a special time out, akin to a "mulligan" in golf.

One business day after the duties were announced, the Chinese government filed a formal complaint in the WTO, alleging that evidentiary thresholds in the U.S. law were inconsistent with U.S. obligations under China's WTO accession protocol and that the law, as such, violated China's rights as a WTO member. A dispute panel rejected China's claims and the WTO Appellate Body later affirmed the panel's findings.

Tit for Tat

Did imposition of the tire tariffs violate U.S. law? No. Did it violate U.S. WTO obligations? No. Was it protectionist? Yes. Was it provocative? Yes.

As China's WTO case on tires was pending, the Chinese government launched its own antidumping (AD) and countervailing duty (CVD) investigations into certain U.S. chicken and automobile exports to China. After losing the tires case at the WTO, China imposed AD and CVD measures on U.S. chicken broilers, raising suspicions in Washington that the measures were retaliatory.

Even if they were retaliatory, they were not ad hoc. The chicken duties were the product of Chinese AD and CVD investigations, which are permissible as long as domestic law and its administration comport with the WTO agreements. Alleging that Chinese administration of the laws violated those WTO agreements, the U.S. government launched a formal WTO challenge in the chicken case in September 2011. A formal panel decision is probably more than one year away, but a similar U.S. challenge of Chinese antidumping and countervailing duty practices in a

case involving "grain-oriented electrical steel" is expected in May.

At about the same time as the U.S. WTO complaint over chicken broilers was filed, U.S. producers of solar panels brought AD and CVD cases against Chinese producers, further ratcheting up tensions. It is important to keep in mind that these cases are brought by industry—not government—so one should resist the temptation to read too much into policy with each new case filing. Nevertheless, this particular industry—the solar industry—has been a darling of the Obama administration, and the implication that Chinese producers benefit from Chinese government largesse, while U.S. producers get no such consideration from their government—though completely beside the matters of law and fact considered in trade remedies proceedings—has been an important cause of rising frictions recently.

Indeed, just after the U.S. International Trade Commission issued its decision to proceed with the solar panels case, the Chinese government imposed antidumping and countervailing duty measures on certain U.S. automobiles. The timing raised new questions about whether the Chinese were engaging in retaliation because the measures stemmed from the investigations that began in the wake of the tire tariffs in 2009 but were never made official until just after the solar panel decision in late 2011.

It is difficult to avoid the conclusion that the automobile duties were retaliatory, but plausible deniability exists in the facts that the duties were issued pursuant to Chinese laws, which do not require duties to be imposed immediately following completion of an investigation, as is the case under U.S. law.

The U.S. Trade Representative's office has not filed a formal WTO challenge of China's automobile restrictions but may be waiting to see the rulings from the steel or chicken cases before bringing a new case along similar lines.

Enforcement, Protectionism, and Provocation

There are important distinctions to draw between enforcement efforts geared toward opening closed markets and protectionist measures designed to close opened markets. But media tend to conflate them and, in the process, obscure important nuances about the U.S.-China economic relationship.

U.S. WTO challenges of discriminatory Chinese policies are not equivalent—economically or morally—to U.S. antidumping, countervailing duty, or safeguard measures imposed on Chinese products. The first is about opening markets; the second is about closing them. The first is about holding China accountable to its commitments; the second is about claiming exceptions to our own commitments. The first is about enforcement; the second is about bestowing favors on some domestic industries at great cost to others.

The United States has filed 12 formal complaints against China, and China has filed 6 formal cases against the United States in the WTO. Those measures have all been about opening markets. Meanwhile, the United States has in place 113 trade remedy measures restricting access of Chinese goods to the U.S. market, and China has in place 20 such measures against the United States. Those measures are all about closing markets.

There is little doubt that certain other Chinese policies would not pass muster at the WTO. China's so-called indigenous innovation policies, forced technology transfer requirements, porous intellectual property enforcement regime, and rare earth mineral export restrictions are some of many legitimate concerns that might justify formal WTO challenges. China's list of protectionist policies may be longer than the U.S. list. But that does not immunize American interests from the consequences of a trade war, which is made more likely by U.S. reactions and characterizations of those Chinese policies.

U.S. policymakers—with the help of a sympathetic media—scapegoat China for a host of homegrown policy shortcomings and assume the inevitability of a bitter rivalry that forecloses the possibility of a mutually beneficial bilateral relationship. The president frequently refers to the imperative of beating China or "winning the future" as a justification for subsidies and industrial policy. The recent establishment of an interagency task force devoted to trade enforcement is so transparently targeted at China as to be provocative. Likewise, the ongoing Trans-Pacific Partnership trade negotiations have been pitched by the administration as a component of its "pivot" toward Asia to counterbalance China's rise. The administration touts its security and foreign policy aspects more frequently than its economic benefits.

Defending U.S. interests in the realm of international trade rules is a legitimate obligation of U.S. officials, but failure to avert a trade war would constitute perhaps the worst dereliction of that duty. So rather than saber rattle over arguably discriminatory Chinese trade policies, U.S. officials should look for actions, gestures, or even changes in tone that could help reduce bilateral frictions.

Reversing Trend and Reducing Tensions

When China joined the WTO in December 2001, one of the many terms it agreed to was to allow the United States to continue treating it as a "nonmarket economy" under U.S. antidumping law for a period of 15 years. The nonmarket economy methodology is a farcically inaccurate way to measure dumping, which usually produces egregiously high antidumping duties, making continued importation from Chinese exporters too risky or too costly for U.S. importers.[7] There are precious few policy actions that would win more goodwill from the Chinese government than a decision by President Obama to graduate China to market economy status now—instead of waiting until 2016. A recent court ruling gives the president the perfect opening to offer that olive branch.

In December, the U.S. Court of Appeals for the Federal Circuit ruled that it is illegal for the executive branch to apply the U.S. countervailing duty law to imports from countries considered to be nonmarket economies under U.S. antidumping law. President Obama can accept that decision, which would require his rescinding 24 U.S. CVD

measures already in effect, terminating five pending CVD investigations, not acting upon two recent case filings, and forbidding his agencies from initiating any new CVD investigations on nonmarket economies henceforth. That would be the best option, but it is highly unlikely.[8] Second, he can seek changes in the law to make it expressly Congress's intent that the CVD law apply to nonmarket economies. That would likely spark harsh reprisals from Beijing in the form of retaliatory tariffs and other market restrictions, as the U.S. measures are perceived as a direct affront to Chinese exporters.

There is a third alternative available, which does not require legislative action, would permit Commerce to simultaneously apply the CVD and antidumping laws to imports from China, and would be considered a gesture of goodwill by the Chinese government. That alternative is for the president to designate China a "market economy" for purposes of the antidumping law—something that the United States is obligated to do under international treaty by no later than December 11, 2016, anyway. Yes, there will be opposition from the interests cited above—labor unions, certain import-competing industries, like steel, and trade lawyers who make their living arguing for measures that would restrict the ability of Americans to trade. But the president should do what he can to avoid a potentially serious fallout with Beijing over trade.

To the extent that unions and domestic industries want to continue to use the CVD law against imports from China, granting China a market economy designation would solve the impasse. The Chinese government wants its exporters to be treated like other countries' exporters, and the United States is obliged to grant that status by 2016. Why not do it now? Chinese exporters would be subject legally to both the antidumping and countervailing duty laws, and they'd actually be happy enough about the change that the crucial bilateral relationship would gets a much-needed boost.

From the perspective of a free trader, that solution is far from ideal: it preserves domestic industries' access to the antidumping law and countervailing duty laws, both of which produce egregiously punitive duties on imports and are ripe for serious reform or outright repeal.

But the benefit of granting market economy status to China now is that it will help slow, and possibly reverse the deterioration in bilateral economic relations. And that would be an important benefit for all of us.

Conclusion

There is no question that some Chinese policies have been discriminatory and provocative, and that the U.S. government has been right to challenge those policies, both formally and informally. But the U.S. government has also indulged in protectionism and made some poor choices that have and will continue to fuel bilateral disputes. There is plenty of blame to go around for the heightened bilateral tensions.

The most significant determinant of the quality and direction of the U.S.-China relationship is American self-confidence. In other words, U.S.-China relations will be driven more by actions in Washington than by actions in Beijing. If the U.S. economy starts to grow at a stronger pace and businesses begin to invest and hire more rigorously, the temptation of politicians and the media to scapegoat China for self-induced, domestic woes will diminish.

Even though China-bashing polls well, responsible policymakers should be looking beyond the politics to find bridges, olive branches, and solutions that remind people in both countries of the importance and mutual benefits of the relationship. Gestures of goodwill could go a long way toward stopping and reversing the recent deterioration of relations.

Notes

1. For elaboration on why the author sees a 1930s-style trade war as highly unlikely, see Daniel J. Ikenson, "A Protectionism Fling: Why Tariff Hikes and Other Trade Barriers Will be Short-Lived," Cato Institute Free Trade Bulletin no. 37, March 12, 2009.
2. For a detailed discussion of this theme, see Daniel J. Ikenson, "Manufacturing Discord: Growing Tensions Threaten the U.S.-China Economic Relationship," Cato Institute Trade Briefing Paper no. 29, May 4, 2010.
3. American Chamber of Commerce in China, "American Business in China," 2009 White Paper, http://web.resource.amchamchina.org/Podcasts/WhitePaper2009.pdf.
4. James McGregor, "China's Drive for 'Indigenous Innovation': A Web of Industrial Policies," American Chamber of Commerce in China, 2010, http://chinadigitaltimes.net/2010/07/china%E2%80%99s-drive-for-indigenous-innovation-a-web-of-industrial-policies/.
5. For greater detail about the tires case and about Section 421, see Daniel J. Ikenson, "Burning Rubber: Proposed Duties on Chinese Tires Whiff of Senseless Protectionism," Cato Institute Free Trade Bulletin no. 39, September 11, 2009; and Daniel J. Ikenson, "Bull in a China Shop: Assessing the First Section 421 Trade Case, Cato Institute Free Trade Bulletin no. 2, January 1, 2003.
6. Of course there have been over 100 AD/CVD measures imposed on imports from China, as well as quotas on Chinese textiles over the years, but the president was never involved in the details or in rendering the final say as he was with tire duties.
7. Daniel J. Ikenson, "Nonmarket Nonsense: U.S. Antidumping Policy Toward China," Cato Institute Trade Briefing Paper no. 22, March 7, 2005.
8. The administration also can appeal the decision to the U.S. Supreme Court or request an en banc judicial ruling from the U.S. Court of Appeals for the Federal Circuit, hoping for a reversal from either body. The likelihood of either the court granting en banc consideration or the Supreme Court granting a writ of certiorari is considered by legal experts to be small.