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The Twilight of the China's Decade?

American Problems with Chinese Trade Policy

The main goal of this article is to present to the European reader the implications of the crisis of the Chinese banking system, which peaked in August 2015, and triggered a period of high volatility in the U.S. stock market. As a result, trade relations between China and the U.S. have deteriorated, which raises the question of whether the Chinese economic system will implode and contribute to the global crisis, or whether it can be controlled by Beijing?

The article assumes two things: that subsidies are at the core of U.S. criticism of Chinese trade priorities; and that to understand recent American-Chinese trade conflicts, we must first review the more general issue of American attitudes towards the subsidizing practices of non-market economies.

The article will conclude with the observation that, in discussing the obvious points that China needs more market-oriented reforms and should be more open to U.S. trade priorities, we may overlook some other more important problems, such as differences in the business cultures of both countries. So, rather than forcing uncertain compromises, American and Chinese trade experts must develop better problem solving skills and discuss new fields of collaboration.

Key words: U.S.-China trade relations, subsidies, non-market economies, Chinese banking crisis, protectionism, Chinese accession to WTO, most-favored nation status, currency manipulations, trade penalties, WTO dispute resolution system

It is unquestionable that the crisis of the Chinese banking system, which peaked in August 2015 and January 2016, affected American monetary markets. The slowdown in the growth of China's GDP, as well as rumors about the forthcoming increase in interest rate by the American Federal Reserve, triggered major volatility in the U.S. stock market. The media began considering whether the Chinese economic system would implode and contribute to the global crisis, or whether it could be controlled by Beijing. To what extent were China's economic problems rooted in politics? Can we expect the end of China's decade?

The main goal of this article is to present to the European reader the implications of the crisis of the Chinese banking system, which resulted in deterioration of trade relations between China and the U.S. The article is relatively short and primarily focused on issues related to American trade policy. So, the reader must be aware that it should be supplemented by the separate studies exploring the economic rather than legal aspects of the problems described therein.

This article assumes two things: that subsidies are at the core of U.S. criticism of Chinese trade priorities; and that an understanding of recent American-Chinese trade conflicts requires a more general analysis of American attitudes towards the subsidizing practices of non-market economies. For this reason, the first chapter starts with an examination of the decisions from the U.S. Department of Commerce and U.S. courts which shaped American countervailing policy (CVD) in the mid-1980s. It will review the evolution of U.S. attitudes towards Chinese subsidizing practices in the first decade of the 21st century. It will also examine the seminal decision made by U.S. courts in *GPX Int'l Tire Corp. v. United States*, the GPX Act of Congress, the WTO's review of the United States' use of "double remedies," and finally, the implementation of WTO directives in America.

The article will conclude with the suggestion that the focus of the trade debate in the U.S. should be changed. Discussing some obvious arguments of American trade experts that China needs more market-oriented reforms and a more open attitude towards U.S. trade priorities would not be very productive. So, rather than pushing the governments towards uncertain compromises, American and Chinese trade experts must improve problem solving procedures and discuss new fields of collaboration.

Historical Background of the "Trade War"¹

The search for the origins of American problems with CVD measures used against non-market economies brings us back to two final negative countervailing duty determinations – *Carbon Steel Wire Rod from Czechoslovakia; Final Negative Countervailing Duty Determination*, 49 Fed. Reg. 19370 (Dep't Comm. 1984) (C-435-001), and *Carbon Steel Wire Rod from Poland; Final Negative Countervailing Duty Determination*, 49 Fed. Reg. 19374 (Dep't Comm. 1984)(C-455-003) – in which the Department of Commerce (DOC) concluded that "the bounties or grants cannot be found in nonmarket economies."

The Department of Commerce's decisions were challenged at the U.S. Court of International Trade in *Continental Steel Corp. v. United States* (614 F. Supp. 548, Ct. Int'l Trade 1985), which held that, contrary to the Department's determinations, U.S. CVD law covers both market and nonmarket economies. However, the U.S. Court of Appeals for the Federal Circuit (CAFC) in *Georgetown Steel Corp. v. United States* (801 F. 2d 1308, Fed. Cir. 1986), reversed this decision and upheld the DOC's determinations. In its key conclusion, the CAFC stated that the Congress

¹ The research for this part of the article was done for the American Bar Association. A summary of the author's comments has been published as a short note in the Quarterly Newsletter, *Customs and International Trade Bar Association (CITBA)*, winter 2014, under the title, "Rebuttable Presumptions—New Developments in the U.S. 'war' with Chinese subsidies." Part of the note has been incorporated (with the permission of the publisher) into this text.

intended to apply only antidumping laws to non-market economies, and that the legislative history provided no indications of its changing attitude.

After more than 20 years of U.S. settled policy, the problem was revisited by the DOC, which realized that some non-market economies, such as China's, may get a lot of double benefits from their WTO membership. On one hand, the agreement that China would be recognized as a non-market economy until 2016 had been incorporated into China's WTO accession protocol. It provided the country with significant trade benefits which stemmed from the recognition that it's economy is still an "economy in transition." On the other hand, the U.S. claimed that, regardless the accession agreement, China must prove that its market-oriented reforms are real and satisfy the standards set by the world's most powerful market economies.

Professor Patrick Mulloy, former Commissioner of the US-China Economic and Security Commission, noted in the book, *Leveraging: A Political Economic and Societal Framework* (ed. by D. Anderson), that until its accession to the WTO, the U.S. administration periodically renewed China's Most Favored Nation (MFN) status. It gave the U.S. broad discretion regarding China's eligibility for low U.S. tariffs. According to the "non-discrimination" clause of Art. 1 of the GATT, China received MFN status on a permanent basis after joining the WTO. Among other benefits, WTO membership protected China from U.S. unilateral retaliatory sanctions imposed under Section 301 of the U.S. Trade Act of 1974.

The fact that under U.S. criteria certain Chinese industries have been granted "a market-oriented economy" status encouraged the DOC to consider the possibility of imposing anti-subsidy (countervailing) duties on imports from China. Also, in light of Chinese currency manipulations, which did not allow the country's Yuan to flow freely, the shift towards more demandable trade policy with China and more generally with non-market economies (NME's), seemed to be justifiable.

Polarization of American Trade Politics

For years, American trade experts have warned that with anticipated financial problems, China may suddenly start selling its foreign currency reserves, which may become an enormous threat for the stability of the American economy. These predictions proved true when China depreciated its currency and sold U.S. dollars and treasury bonds at the beginning of the 21st century – multiple times. (See: Tania Branigan in Beijing and Heather Stewart, *China sells \$34.2bn of US treasury bonds*, 17 February 2010, <http://www.theguardian.com/business/2010/feb/17/china-sells-us-treasury-bonds>; see also: Robert Hennelly, MoneyWatch, August 31, 2015, *China's sale of U.S. debt: Safety valve or cause for concern?*). This intervention in monetary markets, sometimes reaching the level of "manipulation," calls for some introductory comments.

Problems with the Chinese currency – renminbi (RMB–money of the people) – started in 2005, when the Chinese government decided to reevaluate and unpeg the RMB from the dollar. (*A Brief History of the Renminbi (Chinese Yuan– China's currency*. <http://chineseculture.about.com/od/thechinesegovernment/a/RMB.htm>). Unpegging the RMB paved the way for two monetary strategies: rational intervention in China's capital markets; and manipulation of the value of foreign currencies. Below is one example presented by the YChart Incorporation (US): "US Dollar to Chinese Yuan Exchange Rate is at a current (March 14, 2016) level of 6.506 down from 6.531

the previous market day and up from 6.266 one year ago. This is a change of -0.38% from the previous market day and 3.84% from one year ago." (See, *US Dollar to Chinese Yuan Exchange Rate*. https://ycharts.com/indicators/chinese_yuan_exchange_rate). As C. Fred Bergsten and Joseph E. Gagnon of the Peterson Institute for International Economics wrote four years ago in a policy brief entitled, *Currency Manipulation, the US Economy, and the Global Economic Order*, "The United States has (already) lost 1 million to 5 million jobs as a result of this foreign currency manipulation" (12/25, 2012, <http://www.iie.com/publications/interstitial.cfm?ResearchID=2302>).

Although these figures are basically correct, economists note that seeking depreciation, or making a country's currency less expensive, is a normal feature of "easy monetary policy." This policy is used in all major economies, including in the United States. In theory, the depression of a currency should trigger demand for that country's exports, strengthen its economic potential, and create jobs. If, however, the trading partner (China in this case) devaluates its currency according to those of other countries (the U.S. in this case), then the expected benefits of an easy monetary policy fade away. This response to the easy monetary policy may start a "debilitating currency war." (For more information, see the article by Jerry Jasinowski of the same name, 08/02/2013, http://www.huffingtonpost.com/jerry-jasinowski/currency-manipulation_b_3694908.html).

In addition, China, as a primarily export-oriented country, has created a trade imbalance which remains a great concern for the American government and the main political parties. Trump, the newly elected American President, claimed that American imports of Chinese goods exceed the value of American exports to China by \$500 billion. Although Trump overestimated the figures, the U.S. trade deficit with China did hit a record high in the middle of the second decade of 21st century. (<https://www.census.gov/foreign-trade/balance/c5700.html#2015>). To sum up, the governmental subsidies, currency manipulations, and enormous corruption in China have triggered angry reactions from American trade experts for decades. All of these factors resulted in growing tensions between the U.S. and China.

Economic experts in the U.S. basically split into two major camps. The first claims that the Chinese economy is slowing down, but not collapsing. Representatives thereof argue that at the end of the 1970s, China's share of world trade markets was not larger than 0.6%. When this article was written at the beginning of 2016, China was still the second largest economy in the world. Indeed, it had trade agreements with 120 states, and held about 4 trillion dollars in foreign currency reserves. As Ian Bremmer recalled, even with Chinese economic growth slowing down to 7% in 2015, "a total of 38% of global growth last year came from China, up from 23% in 2010" (Bremmer, "The China Decade", *Time*, pp. 40-42).

It is essential for this group to note that sharp growth in GDP during the initial phase of market reforms was observed in the Asian Tigers such as Taiwan, Singapore, South Korea, and Hong Kong. However, these countries, along with Japan, have experienced periods of slower growth in the last two decades.² From this perspective, it can be argued that China's problems may only be temporary and will not necessarily trigger a global economic slowdown.

² For more comments, see R.R. Ludwikowski, *Handel Międzynarodowy*, 3rd ed. C.H. Beck, Warszawa 2012, pp. 159-162.

The second camp of commentators claims that the crisis was inevitable because integration of market instruments with a centrally-governed economy has its limitations. This is a paradox of semi-authoritarian countries – their state-dominated economies require both governmental control and individual discretion in the economic decision-making process. In the opinion of this group, the combination of these two factors in China has created a Pandora's box which, if opened, may affect all other actors of global trade.

U.S. Options in Re-Working Trade Policy Towards NMEs

In considering the larger picture, the United States wanted to be a strong and effective partner for the Asia Pacific region. But Chinese maneuvers, which were taking advantage of America's unclear policy towards non-market economies, could no longer be tolerated. The DOC thus had just two options: either it could lobby for new legislation clarifying Congressional intentions toward non-market and market-oriented economies; or it could initiate CVD investigations without a clear authorization of Congress. Given Congress's trade-related legislative backlog, the DOC opted for the second option.

Since 2006, over two dozen CVD orders have been issued by the DOC against imports from China. The decisions have been challenged in U.S. courts and in the WTO. In both cases China argued that the almost automatic assumption that the governments of non-market economies subsidize imports was the reason for the double counting of the incentives offered to Chinese companies.

In December 2008 China followed up with another complaint to the WTO requesting that its Dispute Settlement Body (DSB) establish a panel to determine the legality of U.S. use of "double remedies" – i.e. simultaneous application of anti-dumping and countervailing penalties. On October 22, 2010, the panel report (Dispute S379) was sent to the U.S., China, and third parties involved in the dispute. The report rejected most of China's claims, and China subsequently appealed. On March 11, 2011, the WTO Appellate Body largely reversed the panel's ruling, concluding that simultaneous use of double duties by the U.S. violates WTO rules.³

U.S. courts were not slow to follow suit. In a landmark decision in *GPX Int'l Tire Corp. v. United States* (2010 Ct. Intl. Trade LEXIS 114, Oct. 1, 2010), the Court of International Trade ordered the DOC not to impose countervailing duties on goods from China, a non-market economy country. The court remanded the case with instructions for the DOC, and on appeal, the CAFC affirmed the CIT decision. The CAFC concluded that "if Commerce believes that the law should be changed, the appropriate approach is to seek legislative change" (*GPX Int'l Tire Corp. v. United States*, 666 F.3d 732, 745, Fed. Cir. 2011).

This time, Congress acted quickly to draft the *Application of Countervailing Duty Provisions to Nonmarket Economy Countries* (Pub. L. No. 112-99), signed by the President on March 13, 2012, as the GPX Act. Also, regarding the application

³ For a detailed summary of both rulings, refer to the World Trade Organization's, *Dispute Settlement: United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, Web. December 2015, https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds379_e.htm.

of countervailing duty provisions of the Tariff Act of 1930 (19 U.S.C. 1671) to non-market economy countries, Congress decided that “the merchandise on which countervailing duties shall be imposed under subsection (a) includes a class or kind of merchandise imported, or sold (or likely to be sold) for importation, into the United States from a nonmarket economy country.” Congress made an exception to the above rule; namely, that CVDs are not required to be imposed when “the administering authority is unable to identify and measure subsidies provided by the government of the nonmarket economy country or a public entity within the territory of the nonmarket economy country because the economy of that country is essentially comprised of a single entity.” Congress also allowed the DOC to adjust antidumping duties should «double counting» occur.

Another Round of the U.S.– China Trade “War”

As was expected, the GPX Act triggered a new wave of criticism in China. Shen Danyang, spokesman for the Chinese Ministry of Commerce, said “China hoped the U.S. would stop its wrongdoing as soon as possible, to preserve fair competition for Chinese enterprises.” He further stated that Congress, contrary to Chinese hopes, and in violation of common trade rules, decided in 2012 to retroactively legitimize the U.S.’s anti-subsidy practices used since 2006 (Shaobin, *News Analysis: U.S. double remedies in question after WTO report*).

In May 2012, China requested consultations with the United States, and on November 14, 2012 the DSB established a new Panel which was asked to review 17 countervailing duty determinations in which the DOC decided that Chinese state-owned enterprises (SOEs) were “public bodies in the meaning of Art 1/1 of the SCM-Subsidies and Countervailing Measures Agreement”.

The WTO Panel rejected several Chinese allegations that the United States misinterpreted certain provisions of the SCM Agreement; namely, Art 2.1 on the specificity test, which makes countervailing measures subject to governmental discretion in selecting the beneficiaries of subsidies. The Panel also did not agree with China’s allegations that the U.S. violated Art 12.7 on “the use of the facts available.” This strategy allows a country imposing CVDs to rely on available information in case subsidizing authorities fail to cooperate.

Nonetheless, the Panel found that the DOC broke certain WTO rules when it presumed that Chinese state-owned enterprises are “public bodies” capable of providing subsidies. The Panel stated, on the basis of former WTO decisions, that state ownership alone does not prove government control. On August 22, 2014, China filed an appeal to the WTO of most of the issues on which the Panel did not rule in its favor. The Appellate Body report was distributed to Members on December 18, 2014.

The implementation of WTO decisions has brought about some interesting procedures in AD/CVD proceedings. U.S. Section 129 of the Uruguay Agreements Act provides for certain actions which must be undertaken in implementing procedures. These include consultations with the U.S. Trade Representative, the International Trade Commission, the Administering Authority of the Commerce Department, and the Congressional Commissions. These agencies are required to determine whether U.S. administrative actions following the WTO’s decisions ended inconsistency with

WTO rules. If the inconsistency would be found, the DOC must revoke or amend its antidumping or countervailing orders.

Since 2012, several AD/CVD rates in Chinese cases have been amended as the final result of recent proceedings under Section 129.⁴ In certain recent cases, including *Multilayered Wood Flooring*, and *Narrow Woven Ribbons*, the DOC has issued notices to interested parties of its intent to conduct a Section 129 proceeding in order to make "a determination not inconsistent with the findings of the World Trade Organization dispute settlement panel and Appellate Body."

Conclusions: Is There Still Enough Room for Negotiation and Compromise?

The new wave of Chinese economic turbulence in January 2016 provoked angry reactions from American presidential candidates, who demanded imposition of punitive tariffs on Chinese imports.⁵ However, representatives of both American parties, albeit reluctantly, had to admit that the imposition of higher tariffs on Chinese imports does not favor American interests in the long-term.

U.S. history, particularly the crisis of the interwar period triggered by the U.S. Tariff Act of 1930 (codified at 19 U.S.C. ch. 4) proved that protectionism may be disastrous and may contribute to economic depression. As Derek Scissors wrote, protectionism "would harm the United States too much, even if it harmed China more / ... /" (in "Deng Undone", *Foreign Affairs*, May-June 2009, pp.39). As claimed above, expectations that state-capitalism will suddenly disappear under pressure from the U.S. are not realistic enough. Therefore, the gradual liberalization of the Chinese economy without resorting to a real trade war seems to be in the U.S.'s best commercial interests.⁶

On June 25, 2014, Daniel R. Russel, Assistant Secretary of the Bureau of East Asian and Pacific Affairs, confirmed the official U.S. position with regard to China in his testimony before the Senate Foreign Relations Committee, stating, "We view China's economic growth as complementary to the region's prosperity, and China's expanded role in the region can be complementary to the sustained U.S. strategic engagement in the Asia-Pacific. We and our partners in the region want China's rise to contribute to the stability and continued development of the region."⁷

From the perspective of China, its recent banking crisis makes the trade relations with other economic superpowers such as the United States not only attractive, but necessary for its survival. So, on the one hand, China keeps questioning the inconsistency of American trade policy towards non-market economies through the WTO

⁴ These Section 129 decisions can be found at: *Enforcement and Compliance*, US Department of Commerce, International Trade Administration Enforcement and Compliance, Web. January 2016, <http://enforcement.trade.gov/download/section129/full-129-index.html>

⁵ See, for example, Haley S. Edwards, "Donald Trump, Tariff-Supporting Free Trade," 15 January 2016, Time.com, <http://time.com/4181999/donald-trump-tariff-free-trade/>

⁶ For more comments, see Ian Bremmer, "State Capitalism Comes of Age," *Foreign Affairs*, May - June 2009, pp. 55).

⁷ US Department of State, *The Future of China -US Relations*, 22.12.2015, Web. December 2015, <http://www.state.gov/p/eap/rls/rm/2014/06/228415.htm>

and American courts. On the other hand, however, China claims that its non-market status expired in December 11, 2016, the day that marked the 15th anniversary of the country's accession to WTO.

The impact of Section 15 of China's WTO Accession Protocol on the country's forthcoming market-economy status has entailed both advantages and disadvantages which cannot be overlooked. The biggest advantage that a market-oriented economy enjoys is the determination of economic developments more by supply and demand, and less by "good relations" with trade partners. Still, the development of market mechanisms is by no means automatic, and progress made by a market-oriented country must be recognized by other world economic powers to some extent.

At this moment, the fact that China, as a market economy, will theoretically be subject to commonly agreed anti-subsidy measures and other unfair trade penalties does not seem to satisfy the "market standards" of the U.S., the EU, or Canada. Testifying before the U.S.-China Economic and Security Review Commission on February 24, 2016, Alan Price, former President of the Committee to Support U.S. Trade Laws (2012-2014), summarized the position of American trade experts:

China is not a market economy. Whether the criteria considered are those under U.S., EU, or Canadian law, the results are the same. Nothing in the international obligations of the United States requires it to treat China as a market economy absent such a finding under national law. Treating China as a market economy when it is not one would have a significant negative impact on the U.S. economy, and would give China a strong and unearned advantage in international trade. It would remove a major incentive for China to implement market-based reforms, and allow it to ignore the commitments it made in its Protocol of Accession to allow prices to be set by market forces.

Reservations such as those presented above undermined confidence in China's intensified lobbying to gain "market economy status." For example, despite China's moderate interest in joining the Trans-Pacific Partnership (TPP) trade negotiations, the country was left out of the agreement. This fact confirms that China, as a state which continues to disrespect international trade and investments rules, may lose important benefits that came with its easy accession to the WTO (Solís, "The Containment Fallacy: China and the TPP").

In summing up the observations presented above, two main reflections come to mind. Firstly, there is no doubt that evaluation of U.S.-China relations is a challenging task, and easing the tension between these two countries requires more than just declarations of goodwill. It is obvious that China needs more market-oriented reforms and must be more open up to American trade priorities. However, lip service only does not contribute to constructive dialogue.

Secondly, both parties must make sacrifices and ease demands which stem from the different business cultures of both countries. Forcing compromises may aggravate economic tensions rather than facilitate collaboration. In other words, trade experts from both countries need more problem solving skills, and must focus on concrete goals. These include: combating global climate change cooperation in space; welfare programs, use of actionable rather than prohibited subsidies; sustainable development of the Asian region;; and common investment projects in Africa and Latin America.

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