The U.S. Offensive in the China Trade War

Michael D. Goldhaber, The American Lawyer (Feb. 26, 2015)

Chinese Furniture Factory in the Guangdong Province, China

The normally conciliatory American Chamber of Commerce in China suggested last fall that China is using antitrust to zap foreign firms. It looked prescient when China last month fined Qualcomm Inc. nearly $1 billion for alleged abuse of market position, and forced costly changes to its license model. Trade wars are old news, but this is something different. Are foreign direct investors now being caught in the cross-fire between U.S. and Chinese exporters?

William Perry of Dorsey & Whitney says they are—and the Americans have it coming, because the U.S. has long used trade law as an instrument of protectionism against China. "The U.S. has taught China how to be arbitrary and capricious," says Perry, who represents Chinese exporters in U.S. trade forums and writes a hot-headed but well-reasoned blog called ChinaTradeWar.com. (The blog also features photos that Perry has snapped of Chinese factories that he's helped to keep open, ranging from a furniture plant in Shenzhen to foundries in Guizhou and Sichuan.) No one says China is blameless, but Perry convincingly puts his finger on a set of contradictions in U.S. trade law that defy economic logic, internal logic and global trade norms.

Nations use trade law to slap high tariffs on imports that they claim were either subsidized or priced below market. In practice, these duties are often so high as to block the imports. U.S. trade remedies block on the order of $10 billion a year of Chinese exports to America, and Chinese trade retaliation (not counting disguised retaliation) blocks on the order of $5 billion a year of U.S. exports to China, according to Perry. Most of the 121 U.S. orders affecting Chinese exports cover raw materials, he notes, which can hurt the U.S. producers they supply.

Chris Cloutier of King & Spalding, who represents U.S. industry in the China trade wars, does not quibble with those numbers. But he stresses that they account for a minute fraction of the two nations' $591 billion in mutual trade last year. Without denying that trade law can be used for protectionist ends, Cloutier defends the system's design.

"Trade remedies are the grease that allows trade liberalization more generally," he says "At a deep level, industry would never agree to free trade without the possibility of remediation."

Perry's main complaint is that the U.S. treats China as a market economy when that helps U.S. industry—and as a "nonmarket economy" when that helps U.S. industry. Communist countries were never sued for

subsidizing private industry, because there was no private industry to subsidize. But in the 2007 "Coated Paper" case, the U.S. Department of Commerce ruled that anti-subsidy ("countervailing duty") law now applies to China, because 80 percent of its prices are market-based: "The role of central planners is vastly smaller." Indeed, economist Ann Lee, author of "What the U.S. Can Learn From China," says that in about half of all economic sectors, the market is freer in China than in the U.S., because the build-up of U.S. regulations creates barriers to entry.

Conveniently, though, when it comes to anti-dumping law, China is still designated a nonmarket economy by the Commerce Department. The main result is that the market price for a product—used to evaluate whether China dumped that good at below-market price, and to calculate the level of duties to assess—is based on the "surrogate values" of raw materials, labor and energy in other nations, rather than actual prices in China.

Cloutier says this does not on balance penalize China. Perry says it does. Further, he says, not knowing which surrogate will be chosen makes it impossible for Chinese companies or their customers to know whether or how much they'll be zapped.

Take crawfish, for example. The market price of crawfish is dirt cheap in China, Perry says, because crawfish have no natural predators, and spread like kudzu. But instead of looking at China's market price, the U.S. looked to Portugal, and slapped on duties of up to 200 percent.

"Although the U.S. government preaches rule of law to the Chinese government, the artificial dumping rates have led [China] to have a very cynical view of U.S. laws," writes Perry. "This view leads the Chinese government to twist its own laws, including the Chinese antitrust law, when applied to foreign and U.S. companies."

But wait, there are other contradictions in the U.S. trade treatment of China, both internal and external. A pair of high-profile cases sharpen Perry's argument.

Under economic logic, to levy both antidumping duties based on surrogate prices and anti-subsidy duties will lead to double counting. King & Spalding saw no statutory basis for this principle, and challenged it in a case against China's GPX International Tire Corp. In December 2011 the U.S. Court of Appeals for the Federal Circuit ruled that Congress had tacitly endorsed the tenet of no double remedies in the nonmarket context. But Congress effectively overruled *GPX,* prompted by Cloutier's lobbying, and expressly authorized double remedies against nonmarket economies.

"When it comes to China," writes Perry, "the Commerce Department's motto is how can we nail you, let us count the ways." Cynical or not, the U.S. position stands in direct opposition to world norms. Although the decision was not even acknowledged by the Federal Circuit in *GPX,* the WTO Appellate Body had held only a few months earlier, in March 2011, that double remedies against a nonmarket economy violates international trade law.

An even more prominent tension between U.S. law and WTO law is presented by the vitamin C antitrust case. In March 2013, a Brooklyn federal jury held a Chinese vitamin C manufacturer liable for more than $150 million in damages for price-fixing, following more than $30 million in settlements by other companies. A July 2011 WTO panel (later overturned on unrelated grounds) had already attributed the price-fixing to the Chinese government—but the Brooklyn jury found that the Chinese cartel did not act under state compulsion.

The irony is that fixing vitamin C prices was an attempt to avoid U.S. anti-dumping duties for driving prices too low, according to China's Ministry of Commerce. The U.S. wins either way, writes Perry: "Smash Chinese companies … with anti-dumping cases based on bogus numbers, and if the Chinese government tries to set an export price floor to deter dumping cases, slam China at the WTO," while U.S. companies sue their Chinese rivals in antitrust.

Sidley Austin's Joel Mitnick—who represented China's Ministry of Commerce in the Brooklyn case, its first venture into the U.S. courts—argued on appeal in January that the court should have deferred to the China's statement that it ordered the price floor. "The notion that a Brooklyn jury should sit in judgment on a foreign nation's industrial policy is absurd," he says. Court watchers agree that the Second Circuit panel showed sympathy for the comity argument. But it remains to be seen whether a remand would compel reversal, or leave the trial court discretion to respect China's statement without kowtowing.

At least the U.S. courts in the vitamin C litigation—unlike the GPX case—were aware of the WTO ruling. Even so, the key question on appeal is the legal consequence of China's position. The WTO ruling itself is regarded as legally inconsequential in the U.S. legal order.

Fordham Law School professor Thomas Lee would like to see that change, as he explains in a forthcoming article in the European Journal of International Law called "Double Remedies in Double Courts." Happily, a test case is likely to appear.

In late 2001, the U.S. negotiated an agreement on China's entry to the WTO. When it expires in late 2016, Perry expects China to argue that the U.S. is obligated, under the agreement's letter and spirit, to give China market economy status. Cloutier expects the U.S. to respond that there is no such obligation unless China meets all statutory criteria for a market economy, including a convertible currency. Around December 2016, the Commerce Department will probably send a Chinese company a questionnaire using nonmarket methodology. The Chinese company will argue in administrative proceedings that this methodology is inapt, and the question will bubble up from there to the highest forums of both global and domestic trade law, including the WTO and the U.S. Supreme Court.

What Lee would like to see is the U.S. courts scrap the model of ignoring the WTO (more politely known as dualism) in favor of a dialogue with international judges who struggle with the same issues.

The Global Lawyer doesn't expect the Supreme Court to become a paragon of cosmopolitanism, but it's probably likelier than Congress or the Commerce Department angering U.S. manufacturers. As a matter of fairness and economic diplomacy, one branch or another of the U.S. government ought to give China the respect it deserves as a mostly free market of incredible dynamism. Or else the trade wars will escalate, and spread to new fields of law. Qualcomm wasn't the first company caught in the cross-fire, and it won't be the last.