Draft April 2017 ……….

Peter Navarro and the Coming China Trade Wars

by Bart S. Fisher*

On December 22, 2016, President-elect Donald Trump announced the creation of the National Trade Council ("NTC"), an entity whose stature the White House said would be equivalent to the "powerful roles of the National Security Council and the National Economic Council,"[1] and the appointment of "vocal China critic"[2] Peter Navarro to head the newly created Council. These two related developments are the largest structural change in the organization of U.S. trade policy since the creation of the United States Trade Representative within the Executive Office of the President in the Trade Expansion Act of 1962. The appointment of Navarro and the creation of the NTC means that the chain of command on U.S. trade policy will now run from President Trump to the NTC to the United States Trade Representative, sharply reducing the importance and significance of the latter office. The head of the NTC will have proximity to the president and the president's ear on trade policy. And in Washington, DC, proximity to power is power. In addition, the appointments of Rex Tillerson to be Secretary of State[3] and Jason Greenblatt to a new Administration position of special representative for international negotiations to assist "with international negotiations of all types, and trade deals around the world"[4]will further undermine the significance of the

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[1] The Washington Post, December 22, 2016, p. A6.
[2] Id.
[3] China Daily, "Trump focuses on trade in diplomat pick," by Zhang Yunbi, December 14, 2016, at p. 1.
[4] The Washington Post, December 28, 2016, p. A2. Trump named Jason Greebblatt, his longtime business lawyer, to the post.

Office of the United States Representative[5]. After all, it is the United States Trade Representative who is supposed to be negotiating trade deals around the world. On January 3, 2017, Robert Lighthizer was named as the new United States Trade Representative. He has yet to be confirmed by the U.S. Senate, another indicator of the reduced prestige of the USTR post.

The Navarro appointment has caused widespread consternation in free trade circles and in China. For example, on December 23, 2016, China Daily thundered that "There is real cause for concern as the President-elect has named Peter Navarro, known for his anti-trade alarmism, as his trade adviser." The New York Times described Navarro as "the author of a series of jeremiads, including a 2012 documentary film, "Death by China," in which an animation of a Chinese knife stabs a map of the United States and causes blood to run freely."[6]

If nothing else, these appointments signal the rise of trade policy in the U.S. Government from "low" politics to "high" politics. Trade policy has now become foreign policy[7]. But how will the Navarro appointment affect the ability of the United States to compete with China? What trade policy shifts will Navarro be likely to champion? The best

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[5] On January 3, 2017, Trump nominated Robert Lighthizer to be the United States Trade Representative.

[6] The New York Times, "Trump Taps Peter Navarro, Vocal Critic of China, for New Trade Post," http://www.nytimes.com/2016/12/21us/politics/peter-navarro-carl-icahn-trump-china-trade.htm, *see also* Forbes, "Trump's Appointment of Peter Navarro To Trade Post Sends Belligerent Signal to China," by Charles Tiefer, December f21, 2016, http://www.forbes.com/sites/charlestiefer/2016/12/21/trump-pick-navarro-means-dangero...; "Beijing Goes Ballistic after Peter Navarro Appointment," www.breitbart.com/california/2016/12/23/peter-navarro-china-reacts/; "Is Trump's appointment of Peter Navarro some kind of joke," by George Koo, Asia Times, December 27, 2016, http://www.atimes.com/navarros-appointment-knd-joke/

[7] On the evolution of trade policy matters from "low" foreign policy to "high" foreign policy, see Cooper, *Trade Policy is Foreign Policy,*" 9 For. Pol'y 18. *See also* C.F. Bergsten, Toward a New International Economic Order 3-10 (1975).

source for guidance here are the publications of Navarro, notably his study, Report of "The China Price Project,"[8] and his book, The Coming China Wars.[9]

The central preoccupation in Navarro's writings is his exploration of how U.S. companies can compete with "The China Price," which has typically been 30% to 50% below the U.S. price. The inability of U.S. companies to compete with this price has resulted in the destruction of many U.S. manufacturing industries. According to Navarro, the China Price is the reason that China has captured over 70% of the world's market share for DVDs and toys, more than half for bikes, cameras, shoes, and telephones; and more than one-third for air conditioners, color TVs, computer monitors, luggage, and microwave ovens[10]. It has also established dominant market positions in everything from furniture, refrigerators and washing machines to jeans and underwear. On an overall basis China's share of global manufacturing has risen from 3% in 1990 to around one-quarter today.[11]China is currently running about a $50 billion *per month* trade surplus with the world,[12] while the United States had a seasonally adjusted $48.49 billion foreign trade deficit in January, 2017, the highest monthly level since March 2012.[13]

Navarro is an unabashed economic nationalist, fighting to promote his agenda against the globalists in the White House. It is fair game to criticize Navarro's overall conclusion that trade deficits are so economically harmful that U.S. policy should seek to eliminate

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8 Navarro, Peter, Report of "The China Price Project," (hereinafter cited as "Report"), Merage School of Business, University of California-Irvine, www.peternavarro.com/chinaprice.html
9 See Navarro, Peter, The Coming China Wars: Where They Will be Fought and How They Wil Be Won, Financial Times/Prentice Hall, 2006; Navarro, Peter, China Price Project
10 *See*Abstract for the Report.
11 "Are U.S. and China Headed for 'Hote war" Over Trade," by Andrw Browne, The Wall Street Journal, March 8, 2017.
12 In October, 2016, China's trade surplus was $49.06 billion, www.tradingeconomics.com, United-States/balance-of-trade.
13 "U.S. Trade Gap Reaches a Five-Year High," by Jeffrey Sparshott, The Wall Street Journal, March 8, 2017.

them,[14] It is commonly accepted that productivity gains accounted for 87.8 percent of lost manufacturing jobs, while trade was responsible for just 13.2 percent.[15] However, Navarro should be given credit for his insightful analysis of the elements of the China Price. Once the relative importance of those elements is understood, the policy prescriptions that he is likely to formulate to counter the China Price become apparent.

A. Elements of the China Price

1. Labor Costs.—The largest single element in the China price is its lower labor costs. According to the research done by Peter Navarro[16], lower labor costs account for 39% of the China Price advantage and clearly represent the dominant element of the China Price advantage over U.S. manufacturers. At first glance, one could say this is just an aspect of the Law of Comparative Advantage, with China possessing a comparative advantage in labor resources.

The problem with that analysis is that workers in China frequently are paid less than the official minimum wage, forced to work excessive overtime, denied overtime pay, denied collective bargaining rights, subjected to abusive treatment, forced to work around hazardous wastes, and in crowded and unsafe working conditions. So mercantilist elements are in fact an integral part of the ostensible Chinese labor cost advantage. Fortunately, this is starting to change, due to pressure from shareholders and organized labor in the United States.

[14] "How to Think About the Trade Deficit," The Wall Street, Journal, March 10, 2017, responding to Navarro's article in the same newspaper "Why the White House Worries about Trade Deficits."
[15] "A double disservice to the Rust Belt," by David Ignatius, The Washington Post, March 1, 2017.
[16] Navarro, Report *see supra* note 7, at p..1.

The example of Apple is instructive. In 2010 conditions at Foxconn, the principal supplier for Apple in China for iPhones and iPads, were so oppressive that there was a rash of worker suicides. Despite the promises that Apple had made to the Fair Labor Association, the group it hired to audit workers' living and working conditions, workers at Foxconn bitterly complained in September, 2012 that they were being forced to work 80 overtime hours a month, and that students were being coerced by teachers to leave school to crank out iPhones at record rates. As a result of worker riots and external pressures Apple has pressed its Chinese supplier Foxconn to increase its wages and improve workers' living conditions. Apple is not alone. The same labor issues persist at the factories of Samsung, Nokia and other brands in China.

Nevertheless, the data indicate that, even adjusted for productivity[17], China's hourly compensation costs are about one-fifth of U.S. labor costs. China's wages are four times lower that Brazil and seven times lower than Mexico[18].

In most cases, one would expect this type of wage advantage to shrink over time as labor markets tighten in tandem with economic growth. The problem with China, however, is that the Chinese government is seeking to move 400 million people from the countryside and into China's cities over the next several decades. To put these numbers in perspective the current work forces of the United States and Europe *combined* number less than 400 million.

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[17] Since 1990 productivity in manufacturing as a whole in Brazil and Mexico has grown by a factor of approximately 1.4, but manufacturing productivity in China has increased by a factor of almost seven. K. P. Gallagher and R. Porzecanski, ,The Dragon in the Room: China and the Future of Latin American Industrialization (2010), at p. 120.

[18] Id.,, at p. 119.

Thus, despite much higher growth levels than the United States, and external pressures such as the Apple case mentioned above, wage pressures will remain a significant driver of the China price for decades to come.

2. Subsidies by China.—The second largest element in the China price is export subsidies provided by its governmental units. According to Navarro, this accounts for about 17% of the China Price advantage[19]. As a condition of its entry into the World Trade Organization (WTO) in 2002, which I argued for publicly,[20] China agreed to eliminate or scale back its complex web of subsidies and tax preferences that benefit its export manufacturers. Unfortunately, this has not happened rapidly enough. Apart from significant domestic subsidies such as heavily subsidized energy and water, China continues to use its state-owned banks to provide non-performing loans (NPLs) to the state-owned enterprises (SOEs) centered in heavy industries such as steel and petroleum. These non-performing loans allow otherwise inefficient SOEs, known in China as the dinosaurs, to export when by all rights they should be allowed to go bankrupt, as would happen in a true market economy.

China's exports are further aided by its extensive value-added tax rebate system. The Chinese VAT is imposed over multiple stages of production, in the range of 13% to 17%. By exempting this tax on its goods destined for export, China gains a huge competitive advantage over its counterparts in the Americas.

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[19] Report, *supra* ,note 7 at p. 1, and pp. 10,11.
[20] Fisher, Bart, "Let China in the WTO, "The Washington Post, April 5, 1999.

Other direct subsidies to Chinese manufacturers include its Export Development Fund for the larger firms, the Fund for Small and Medium Enterprises, and the Chinese Export-Import Bank[21].. Clusters of subsidies around specially designated regions,.

3. Chinese Currency Manipulation.—No Chinese trade-related practice has received more publicity than its currency manipulation. Here we are dealing with a moving target. In 2006 Navarro estimated that currency manipulation contributed 11% to the China Price advantage[22]. But the yuan at that time was trading at about an 8 to 1 ratio to the U.S. dollar. At that point estimates by others of the undervalued yuan ranged from 40% by Ernest Preeg to 25% by the Institute for International Economics. However, the yuan now trades at a ratio of about 6.2 to the dollar, so China has gradually appreciated its currency. The Obama Administration declined to name China a currency manipulator, noting that it has let the yuan rise nearly 10 percent in value against the dollar since June, 2010.

A major problem in the currency manipulation debate is that the alleged practice lies largely in the eyes of the beholder. China has alleged that the United States, through the quantitative easing policies of its Federal Reserve System, has effectively devalued the U.S. dollar, thus manipulating its currency. And in fact other countries, such as Singapore, Korea, Taiwan, and Japan, also manipulate their currencies.

Mexico has also complained about China's currency manipulation, as the Mexican peso appreciated 21% against the dollar from the mid-1980s through 2006 by 21%, while

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[21] Gallagher, Kevin and Porzecanski, supra note 11, at 127.

[22] Report, *supra*, note 7, at p. 1, p. 16. Navarro has also been critical of Germany, accusing it of using a "grossly undervalued" euro to "exploit" the U.S. and its EU partners. Navarro has argued that the euro is an "implicit Deutsche Mark" whose low valuation gives Germany an advantage over its main trading partners. "Trump trade chief accuses Berlin of using weak euro to exploit U.S., Financial Times, February 1, 2017.

the Chinese currency depreciated[23]. And the Brazilian Government has called for a revaluation of the yuan, contending that the cheap Chinese yuan is flooding into Brazil and hurting local manufacturers[24]. So this is an issue for all of the Americas, not just the United States.

4, Network Clustering.—Perhaps the most unexpected competitive advantage China possesses is network clustering. Navarro estimates that this currently amounts to a 16% competitive advantage for China[25]. Network clustering refers to the practice of locating all or most of the key enterprises in an industry's supply chain in close physical proximity to one another. China has raised network clustering to an art form, with whole cities dedicated to the production of particular products. For example Yanbun is the underwear capital of China; Foshan and Shunde are the major hubs for appliances like washing machines, microwave ovens, and refrigerators; Huizou in the Pearl River Delta area of China is the world's largest producer of laser diodes and a leading DVD producer. Leilu focuses on bicycles, Wenzhou on commercial kitchen equipment, Chencun on flowers, and so on.

The importance of network clustering is that it reduces transportation costs by locating the factors of production closer to one another. It reduces inventory costs by speeding up throughput times. And it reduces down time in the supply chain by smoothly moving all links in the supply chain in a coordinated fashion.

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[23] Gallagher, Kevin and Porzecanski, supra note 11, at p. 95.
[24] Shannon, Kerri, "Latin America Looks to Strengthen U.S. Trade Relations and Step Back from China," Money Morning, March 17, 2011, http://moneymorning.com/2011/03/17/latin-america-looks-to-strengthen-u-s-trade-relation
[25] Report, *supra* note 7, at pp. 1, 12, 13.

In other words, China has specialized in turning logistics and supply chains into profit centers.

How has China been able to do this? The reason is that it is a planned economy, with 5-year plans organized and approved by the State Council. The United States is simply not organized in such a fashion, but I would suggest that freedom for our enterprises to locate where they wish to locate is a trade-off worth making. However, this raises the broader issue of industrial policy, targeting, and what will work best in the 21st century--the Beijing Consensus or the Washington Consensus, which emphasizes free and open markets. Generally speaking, the countries in the Americas have opted for the Washington Consensus, through the fairly rapid liberalization of its trade and investment regimes, and the general decrease of the role of the state in economic affairs[26]. Mexico, for example, shifted from its state-led industrialization strategy in 1988 to pursue a market-led strategy. At this point Latin America is one of the more open market regions in the world[27].

The ascension of Peter Navarro makes it likely that the Trump Administration will turn to a supply chain switch that will focus on unwinding and repatriating the U.S. overseas supply chain to U.S. production.[28] Thus it is likely that Navarro will attempt to use the NTC as a mechanism to promote domestic U.S. production into a U.S. version of network clustering.

5. Foreign Direct Investment.—The fifth driver of the China Price has been direct

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[26] Gallaher & Porzecanski, supra note11, at p. 4.
[27] "U.S. – Latin America Relations: A New Direction for a New Reality," Council on Foreign Relations Independent Task Force Report No. 60, at p. 5.
[28] "U.S. trade chief drives supply chain switch," Financial Times, February 1, 2017. "It does the American economy no long-term good to only keep the big box factories where we are now assembling 'American' products that are composed primarily of foreign components," he told the Financial Times" Id.

foreign investment. As massive amounts of foreign capital flood into China its efficiencies improve dramatically. Foreign investment into China has grown at 17% annually for five years, and among developing nations, China has become the leading destination for Foreign Direct Investment (FDI). Since 1983, FDI into China has grown from less than $1 billion per year to over $60 billion. And 72% of China's FDI targets manufacturing. One can see the synergy here. The undervalued currency, which we spoke about earlier, provides a huge incentive for FDI.

Ironically, so does the U.S. tax code. The U.S. multinational enterprises are actually encouraged to invest abroad as a result of the tax privilege of deferral. Under the U.S. tax code a U.S. multinational enterprise established as a subsidiary is not taxed in the United States on the foreign source income that it earns abroad unless such foreign income is repatriated in the form of dividends, except in very limited situations[29]. This tax privilege of deferral is in essence a subsidy that encourages U.S. multinationals to operate abroad. Deferral amounts to an interest-free loan by the U.S. Government for income that is accumulated until dividends are repatriated to the parent[30]. Deferral thus encourages overseas investment over new investment in the United States.

Since approximately 30% of the exports from China to the United States are from affiliates in China we can see the untenable situation that now exists. Inter-affiliate imports, so-called "captive imports," encouraged by the U.S. tax code, are made in China and re-exported to the Americas. Obviously the MNEs are going to China to reap the benefit of

[29] Fisher, Bart, "The Multinationals and the Crisis in United States Trade and Investment Policy," 53 Boston University Law Review (March, 1973), at pp. 338, 339.
[30] Id., at p. 347.

China's other competitive advantages as well, but the U.S. tax code gives them a running start.

And with the increased FDI comes increased technology transfer, as Chinese enterprises will form Joint Ventures that contractually obligate their foreign partner to share knowledge and technology with the local partner.

In an effort to escape this technology transfer trap, foreign investors are now increasingly establishing wholly-owned foreign enterprises (known as WOFEs). Today WOFEs account for 65 percent of new FDI in China and they dominate high-tech exports. WOFEs account for 62% of industrial machinery exports, 75% of exports of computers, components, and peripherals, and 43% of exports of electronics and telecommunications exports.

Navarro estimates that catalytic Foreign Direct Investment accounts for 3% of the China Price advantage[31] but this appears low, since 30% of China's exports to the United States are inter-affiliate exports, i.e., from an affiliate of a U.S. enterprise to its parent.

6. Counterfeiting & Piracy.—Navarro has observed that "Following a centuries-old tradition of skullduggery in the South China Seas, Chinas has become the world's largest pirate nation."[32] According to Navarro, counterfeiting and piracy

account for about 9% of the China Price advantage[33]. Counterfeiting and piracy enables Chinese companies to save research and development and the marketing expenses required

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[31] Report, *supra* note 7, at p. 1,14,15.
[32] Navarro, *supra* note 8, at xii.
[33] Id., at 1,5,6.

for brand building. Much of China's counterfeiting and piracy is state-sanctioned[34]. In one case I worked on it was the Chinese Government's official printing press in Shanghai that was knocking off the Chemical Abstracts, costing the American Chemical Society, which was my client, $40 million per year[35]. China had exactly 9 subscriptions to cover its 1.3 million scientists, and dozens of universities, research institutes and think tanks that were using the publication. And the rate of software piracy in China is well over 80%, with the government often the worst offender.

On average 20% of all consumer products in the Chinese market are counterfeit. And, if a product sells, it is likely to be duplicated. Of small comfort is the fact that U.S. companies are *not* being picked on in this regard, as pirates and counterfeiters target both foreign and domestic companies.

7. Other Aspects of the China Price.—The remaining areas where China secures a competitive advantage over other countries include minimal worker health and safety regulations[36] and lax environmental regulations and enforcement. Cumulatively, according to Navarro, these factors amount to about 5% of the China Price advantage[37].

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[34] As Professor Daniel K. Chow of Ohio State University has pointed out, "No problem of this size and scope could exist without the direct or indirect involvement of the state. In China, the national government in Beijing appears to be sincere in its recognition of the importance of protecting intellectual-property rights, but national ;level authorities are policy and lawmaking bodies, whereas enforcement occurs on the ground at the local level. At this level, local governments are either directly or indirectly involved in supporting the trade in counterfeit goods," Statement of Daniel C.K. Chow, Congressional Executive Commission on China, May 16, 2005. "Intellectual Property Protection as Economic Policy: Will China Ever Enforce Its IP Laws? http://www.cecc.gov/pages/roundables/051605/Chow.php.

[35] The saga of the Chemical Abstracts case is discussed in Mufson, Steven, "Piracy Still Runs Rampant in China," The Washington Post, March 37, 2998.

[36] Harney, Alexandra, The China Price: The True Cost of Chinese Competitive Advantage (The Penguin Press, 2008) at pp. 56-71.

[37] Report, *supra* note 7, at p. 1,8,9,10.

B. Countering the China Price

The Navarro analysis of the China Price advantage would suggest that the United States move relentlessly against the perceived "unfair" trade practices of China, adopt a more vigorous industrial policy, and adopt U.S. tax reform measures that will neutralize the China Price advantage. The question is whether those measures will be enough to stem the job-killing tide of imports from China, or whether an additional tariff will have to be imposed on imports from China. Trump has suggested a duty of 45% to level the playing field vis a vis China (and a tariff of 20% against Mexico), but his Secretary of Commerce-designate Wilbur Ross has denied that such a duty would be imposed, and suggested that the threat to impose such a duty by Trump is leverage for trade negotiations with China.

1. Unfair Trade Practices

Navarro's likely initial focus will be on the vigorous enforcement of the unfair trade practice laws of the United States, including the antidumping laws, the countervailing duty laws, and the laws protecting U.S. manufacturers from the theft of their intellectual property, including patents, copyrights and trademarks.

a. The Antidumping Law of the United States.

Dumping occurs when there are sales in the United States at less than the home market price, known as "fair value." There are two new challenges to the U.S. antidumping laws that need to be addressed, and they both come from China. The first challenge is that of circumvention of the U.S. antidumping laws, and it relates to steel cases launched by the U.S. Government on November 8, 2016, against steel allegedly being dumped by Vietnam.

Vietnam has emerged as the biggest new source of steel in the U.S .market this year, with imports from Vietnam increasing to 556,000 metric tons during the first nine months of 2016, from 36,000 tons in the first nine months of last year, a surge that has depressed U.S. steel prices, and kept pressure on the profit margins of the U.S. steelmakers. The catch here is that much of this steel really comes from China, which has built up networks of companies in Vietnam that are in effect their subsidiaries. Thus, corrosion-resistant steel being exported from Vietnam into the United States is in reality Chinese steel coated in Vietnam with zinc. The legal issue is whether the zinc added in Vietnam is enough to permit U.S. importers to successfully assert that a "substantial transformation" of the product has occurred when the steel is coated. It is noteworthy that the Chinese antidumping law circumvention occurred after the United States had imposed antidumping duties as high as 266% on Chinese steel, a move that, at least for a short while, allowed the U.S. steel makers to charge more for their products. The circumvention by the Chinese of the U.S. antidumping laws must be stopped. That is the first challenge that will confront the Trump Administration. In other words, for Trump to make America great again, he will have to make the antidumping laws of the United States great again.

The second issue related to the antidumping laws is the classification of China as a non-market economy. China has argued, citing its WTO 2001 accession protocol, that it is a market-oriented economy. If it is so classified, it will be virtually impossible to assess antidumping duties against China because its home market prices are so low. The classification of China as a nonmarket economy permits the U.S. Commerce Department to resort to the economy of a third country at a comparable stage of economic development to calculate the home market "fair value" price, and the country usually chosen for that

analysis is India. This exercise is generally referred to as calculating the "constructed value" of the home market price. The reality is that China is still a non-market economy, and the U.S. Government must hold firm to that position, even if the European Union, for political reasons, chooses to classify China as a market-oriented economy. China has complained bitterly that its continued classification as a nonmarket economy is unfair. The reality, however, is that China's foreign exchange regime is still controlled by its State Administration of Foreign Exchange (SAFE) and its many state-owned enterprises, the so-called dinosaurs, still dominate the economy. Navarro has stated many times that China is a non-market economy, so it is unlikely that the United States will now recognize China as a market-oriented economy.

b. The Countervailing Duty Laws of the United States

The countervailing duty law of the United States permits the United States to assess duties equal to foreign subsidies, bounties, or grants for foreign goods entering the U.S. market. Navarro will no doubt argue that this statute needs to be more vigorously enforced. For example, there is an action now pending against Chinese subsidies for its aluminum exports to the United States. China's aluminum exporters now benefit from government reductions on their energy bills and tens of millions of dollars in cash infusions. Subsidies such as these have propelled the surge in China's aluminum production in recent years, which has increased from 24% 10 years ago to 55% of global production in 2015. China has also been circumventing prior countervailing and antidumping duties amounting to 374.15% by importing products such as aluminum pallets from China, which is just aluminum being reshaped in order to avoid the punitive U.S. duties. China started to use these new methods

to sell aluminum in the United States after the tariffs were imposed, indicating that they were designed to avoid trade barriers[38].

As noted above, Peter Navarro has argued that the most pressing subsidy-related issue is that of alleged Chinese currency manipulation. In the 1990s and early 2000s China held down the value of its currency, called the yuan or renminbi, to the detriment of U.S. producers, who could not compete with the lower-priced Chinese goods, and U.S. exporters, who found that their goods could not compete with China's low prices abroad. The argument at that point was that China was granting an unfair subsidy for its exporters, and that that Chinese goods should be penalized under the countervailing duty laws of the United States. However, as noted above, the time for that argument may have come and gone. While the yuan was 8.2 RMB to the dollar in 2002, it is now at about 6.2 to the dollar. It has thus *appreciated* vis a vis the dollar, rather than depreciated. However, this picture could change tomorrow, and Navarro will no doubt argue that the United States must not take that risk. The reality is that China has cleverly played this issue, and that new rules of the road are needed, either in the WTO or IMF, to stop currency manipulation. Meanwhile, the Trump Administration has declined to designate China as a currency manipulator.

c. Intellectual Property

[38] An element of mystery has been added to the China aluminum dumping case by the report that China Zhongwang Holdings Ltd has been moving massive quantities of aluminum stockpiles to countries such as Vietnam and Mexico in order to avoid U.S. antidumping duties. 1.7 million tons of aluminum have been stored in Vietnam since 2015 by a company owned by one of the business associates of the Chairman of Zhongwang Holdings Ltd. The U.S. Department of Homeland Security and Commerce Department are now investigating complaints that the Chinese Company was disguising its metal in a form not specifically covered by the 2010 antidumping restrictions. "The Saga Behind an Aluminum Stockpile," Scott Patterson, The Wall Street Journal, p. B1, December 29, 2016.

A major tool in the tool kit to improve the U.S. trade posture is Section 337 of the Tariff Act of 1930, which permits the United States to issue exclusion orders against imports that compete unfairly, and covers patents, copyrights, trademarks, and potential antitrust violations. The majority of Section 337 actions are against China, and the majority of those cases involve patent-based violations. Section 337 enforcement needs to be expanded. It is the "catch all" statute designed to limit imports that are competing unfairly in the U.S. market.

2. Fairly Priced Imports

A consensus exists that imports that are unfairly competing the U.S. market need to be limited. The controversy exists with regard to goods that are fairly priced that are still entering the U.S. market in numbers large enough to seriously injure U.S. industries.

President-elect Trump has called for a tariff of 45% to be imposed on China's imports. There are four statutes that would now permit Trump to carry out the threat of higher U.S. tariffs. The first statute that the Trump Administration has chosen to wheel out into the field of battle is Section 232 of the Trade Expansion Act of 1962. Under this statute the President can declare that for national security reasons he can limit imports coming into the United States.[39] The problem with the use of this statute is that with current U.S. unemployment levels at 5%, which most economists would term nearly full employment, it is difficult to make the "national security" case under Section 232. On April 21, 2017,

[39] Section 232 of the Trade Expansion Act of 1962 provides that if the secretary of the treasury finds that an "article is being imported into the United States in such quantities or under such circumstances as to threaten the national security," the president is authorized to "take such action, and for such time, as he deems necessary to adjust the imports of (the) article and its derivatives so that imports (of the article) will not threaten to impair the national security."

President Trump called for a study under Section 232 to see whether imports of steel are a national security threat to the United States and should therefore be limited.[40] To satisfy the terms of the statute, the Trump Administration would have to make the factual finding that the United States currently lacks the domestic production of steel necessary to meet the requirements for the national defense of the United States.[41]

Another likely candidate for the unilateral imposition of duties is Section 301 of the Trade Act of 1974. Under this statute the President can impose duties or quantitative restraints against countries whose governments impose barriers to U.S. exports that are unreasonable, discriminatory, or unjustifiable. The term "unjustifiable' is defined as unlawful or violating existing trade agreements. Section 301 permits the Office of the United States Trade Representative to self-initiate trade actions against foreign countries its deems to have acted unfairly against U.S. exports.

There is also a statute that allows the president to limit imports if they are seriously injuring a U.S. industry, and a statute allowing the president to limit imports from nonmarket economies that cause market disruption in the United States market.

The overall point to be made here is that a granular analysis of the existing statutes that regulate unfair foreign trade practices and fairly traded foreign goods needs to be

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[40] "Trump Roars Again on Trade, Reviewing Steel," Mark Landler, New York Times, April 21, 2017.
[41] Section 232 (c) states that "For the purposes of this section, the Secretary and the President shall, in the light of the requirements of national security and without excluding other relevant factors, give consideration to domestic production needed for project national defense requirements, the capacity of domestic industries to meet such requirements, existing and anticipated availabilities of the human resources, products, raw materials, and other supplies and services essential to the national defense, the requirements of growth of such industries and such supplies and services including the investment, exploration, and development necessary to assure such growth, and the importation of goods in terms of their quantities, availabilities, character, and use as those affect such industries and the capacity of the United States to meet national security requirements…"

undertaken, with the emphasis being given to unfair foreign trade practices in general, and antidumping enforcement in particular.

A border adjustment tax ("BAT") has also been proposed by Speaker of the House Paul Ryan but opposition in the Senate is likely to prevent this approach to limiting imports.[42]

3. Trade Agreements

Trump asserted that U.S. trade agreements, including NAFTA, have been a "disaster" that have cost U.S. workers millions of jobs.

a. NAFTA

Despite the assertion by President-elect Trump that NAFTA has been a "disaster" that has injured the U.S. economy, the consensus view among economists is that the net overlal effect of NAFTA on the U.S. economy appears to be relatively modest, primarily because trade with Canada and Mexico accounts for a small percentage of the U.S. GDP, less than 5%. Trade with Mexico amounts to 1.4% of the GDP. On an overall basis, the Congressional Budget Office has estimated that NAFTA probably increased U.S. GDP, but by a very small amount, probably no more than a few billon dollars, or a few hundredths of a percent. The International Trade Commission has confirmed this estimate, stating that NAFTA has had small, but positive, effect on the *overall* U.S. economy.

[42] See "The Border Adjustment Tax Would Unleash World Trade Disorder," by Bart S. Fisher, Richmond Times-Dispatch, April 1, 2017. And see "Import tax splits White House," by Damian Paletta, The Washington Post, March 4, 2017.

There have, however, been some worker and firm adjustment costs as the three countries adjusted to more open trade and investment among their economies.

Given that the U.S.-Canada Free Trade Agreement was negotiated and signed in 1987, and was therefore already in place in 1993, most of the market opening measures in NAFTA results in the removal of U.S. tariffs and quotas applied to imports from Mexico, and Mexican trade barriers applied to imports from the United States and Canada. At the time NAFTA went into effect, about 40% of U.S. imports from Mexico entered duty-free and the remainder faced duties of up to 35%, with a trade-weighted average of about 11%.

The central point is that NAFTA has worked as intended. It has had both an economic and a political dimension. While the United States could legally withdraw from NAFTA six months after Mr. Trump notifies Mexico and Canada of his intention to do so, it would be unwise to do so. It is in the interest of the United States to prop up the economy of Mexico, in order to relieve the pressure from illegal immigration into the United States, and withdrawal from NAFTA would raise the price of U.S. automobiles by increasing the costs in the established global supply chains. Cars sold in the United States have many foreign parts, with components sourced on the basis of quality and price. Placing tariffs now on automobiles and automobile parts from Canada and Mexico would in fact increase the cost of cars in the United States, and, ultimately, save very few jobs in the United States. About $118 billion in cars and auto parts moved tariff-free between the United States and Mexico last year. If a tariff were imposed, it would take years for companies to rebuild their global supply chains. In the meantime, U.S. consumers would pay significantly higher prices for their daily purchases.

The fact of the matter is that Trump totally politicized the so-called "disastrous" effect of NAFTA for his political advantage in the Rust Belt states. NAFTA should be left alone. The only change that could be justified, in fact, would be to expand the agreement to encompass a free market in electricity between the United States and Canada.

Among the biggest openings involves imports of clean electricity from Canada, where hydropower provides the bulk of the nation's power supply, with plenty to spare.

Electricity harnessed from dams and reservoirs in Quebec, Manitoba,Ontario and British Columbia accounted for 63% of Canada's electricity supply in 2015, with nuclear energy following at 13%, and wind energy way behind but growing at 2%.

All told, 83% of Canada's electric generation is emission free, compared to 32% for power supply in the United States, and 25% for those in Mexico. If six projects now underway are completed, Canada will be able to increase its electricity exports to the United States by 50%. The development of a free trade area in clean energy between the United States, Canada, and Mexico is very much in the interest of the three countries. The correct policy prescription for NAFTA is to expand it, and not limit or terminate the agreement.

It is telling that there has been no mention of an initiative to scrap NAFTA by Trump since the election. It is likely that Navarro will recognize that there is no need to scrap NAFTA and that it will either endure with minor modifications or be absorbed into a larger Free Trade Area of the Americas ("FTAA").

b. Trans-Pacific Partnership

On the first day of his presidency President Trump made the fateful decision to withdraw from the Trans-Pacific Partnership ("TPP").

While President-elect Trump was incorrect in his criticisms about NAFTA, he was correct in asserting that the TPP is fatally flawed and should not have been approved in its present form. For starters, the TPP allows for self-certification of exporters. Thus, Vietnam, for example, could export products to the United States with 90% of the product being produced outside of a TPP country. These weak rules of origin would give China no incentive to join the TPP to benefit from the agreement.

Note the comments made earlier about the circumvention of the U.S. antidumping laws currently taking place in the cases of steel and aluminum from China. The TPP, as currently drafted, would actually *expand* the circumvention possibilities for China, in effect just giving China duty-free treatment with no corresponding concessions on its side.

Another flaw in the TPP is that it does not proscribe currency manipulation, an issue also discussed earlier.

The TPP needs to be totally revisited, and improved, not discarded. It needs tough rules of origin, and coverage of currency manipulation.

In a perfect world we would prefer global trade agreements but the stalled Doha Round of multilateral negotiations has required a regional pact.

The United States needs to trade with Asia. But it should insist on an improved TPP before completing its pivot to Asia. One thing is clear. It can not abandon the field in Asia

to China. It must compete with a better trade arrangement, or risk becoming a second-class power in the Pacific, which is not in the U.S .national interest.

It is likely that Navarro will recommend interim bilateral trade deals with Japan and China, rather than a relaunching of the TPP negotiations. That train has left the station.

c. Free Trade Area of the Americas

While the wrinkles in the TPP are being ironed out the United States should increase its economic integration with Latin America. The case for viewing the competitive threat of China through the prism of overall U.S.-Latin America relations is simple. The United States has neglected Latin America for too long and Latin America has never mattered more to the United States.[43]

The first key point is that geography is destiny. The long United States border with Mexico remains porous, and the emphasis now needs to be shifted from trade in goods and services, to the factors of production, namely labor.

For example, it should be the goal of U.S. policy to make Mexico as rich as the United States. Otherwise, there will be more illegal immigration.

President Reagan had it right when he called for a Free Trade Area of the Americas ("FTAA") that would involve the 34 democratic countries in the Western Hemisphere. Under the best of circumstances negotiating such a trade agreement among so many parties would be difficult. And these recent years have not been the best of circumstances. The

[43] U.S.-Latin America Relations: A New Direction for a New Reality," Council on Foreign Relations Independent Task Force Report No. 60, at p. xi.

security imperatives of a post 9/11 world, the war on terror, and a global recession and financial crises that have struck all the Americas in varying degree have made negotiations on such a broad agreement difficult. But negotiations for the FTAA can and should be placed back on track.

Such a broad agreement, by promoting hemispheric unity, could counter the China Price and China's relentless push into Latin America.

The United States should induce Brazil into an FTAA by slashing subsidies and committing to liberalization in politically sensitive areas such as cotton, sugar, tobacco, and citrus[44].

At a minimum, the Trump Administration should seek to harmonize the existing trade blocs and areas now existing in the Americas, including NAFTA, CAFTA, Caricom, Mercosaur, and other trading blocs.

The U.S. business community would support such an initiative, which would reinvigorate the outflows of U.S. equity capital required to promote the economic development of the Americas.

Summary

The inherent contradiction in Trump's platform is that the pro-growth agenda of lower tax rates and less regulation runs into his anti-trade instincts, which are distinctly anti-growth and redistributionist. The fragile economies of Europe, China, and Japan could

[44] Schott, Jeffrey J. Does the FTAA Have a Future, Institute for International Economics, November, 2005, at p. 12.

bloom into a global financial crisis at any minute. Achieving trade reform without sparking a global trade war should be the objective of the next Trump Administration.

The prescriptions of Peter Navarro are now married to President Trump's trade instincts. What Peter Navarro brings to the Trump Administration is an intimate knowledge of what is going on in China and how to counter the Chinese trade practices that have given them a competitive advantage. His proximity to the president will give him enormous power. The competing power centers in the White House, frequently described as the "globalists,"[45], such as Jared Kushner, President Trump's son-in-law, and Gary Cohn, a former Goldman Sachs banker and Chairman of the National Economic Council, will provide a major counterweight to Navarro's influence.

Navarro's key ally in pursuing what can be fairly described as a "nationalist" trade agenda is Stephen K. Bannon, the president's chief strategist. Wilbur Ross, the Secretary of Commerce will also be influential in all major trade-related discussions dealing with China. He recently stated that we are already in a trade war with China.[46] Whether Navarro, an academic with his chance to finally make a mark on trade policy, can succeed in doing so remains to be seen. At the end of the day it will be Trump will set the U.S. trade strategy with China. And, ironically that strategy may be controlled by other geopolitical factors related to U.S.-China relations, such as how to deal with North Korea and its nuclear ambitions. As Trump has said, without the trade issue he probably would not be in the White House. How skillfully he plays his hand may determine how history judges his presidency.

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[45] See, for example, "Trump Roars Again on Trade," by Mark Landler, New York Times, April 21, 2017
[46] "Dubbed the "king of bankruptcy" for his leveraged buyouts of battered companies in the steel, coal, textile and banking industries, Ross has generated a fortune of $2.5 billion…" "Billionaire investor Ross confirmed as commerce secretary," by Ana Swanson, The Washington Post, February 28, 2017.

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