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China: overview of US and EU trade policy

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Over the past several years, China has become an increasingly important factor in international trade policy in both the United States and the European Union. While the US and the EU have their share of disputes between them, they seem united in a view of China as the one country with the greatest potential to cause trade imbalances and disrupt domestic industries. At the same time, China has made important strides in economic and legal reform, and is likely to continue to be both a vital export market and a production base for many US and EU companies. This commercial reality, along with broader political concerns, has led both jurisdictions to seek amicable solutions to potential Chinese trade problems. However, major tests of trade policy are looming. Cyclical trends and the end of long-term quotas in sensitive sectors mean that significant conflicts with China could soon develop. This overview discusses recent trade policy thinking in the US and the EU with respect to China, and offers a preview of some of the key issues likely to face US and EU trade policy makers in the coming years.

WTO

The most significant development with respect to China in the international trade arena in recent years was China's accession to the WTO in December 2001. With this signal event, China formally entered the international trade community, with all the rights and obligations that step entails.

To qualify for accession, China agreed to make substantial revisions to many of its domestic regulatory and legal structures in order to bring them into conformity with WTO norms. Full implementation of these commitments is to be completed by December 2007, and in the past four years, China has taken important steps to satisfy these obligations. One concrete sign of the efforts China has made to open its market is the fact that US exports to China have more than doubled since 2001. While some of this growth surely results from China's phenomenal productivity and demand for raw materials, this trend also reflects to some degree China's removal of restrictions on the entry and sale of foreign products.

Notwithstanding these accomplishments, China is still seen as lagging in some important areas, the most obvious of which is protection of intellectual property rights (IPR). In the view of the US, while China's laws have been substantially revised, China continues to tolerate unacceptably high levels of IPR infringement, piracy and counterfeiting. While China's WTO commitments have been found lacking in other areas as well, particularly services and agriculture, IPR remains the major sticking point.

By acceding to the WTO, China also opened itself to the dispute settlement process. The US brought its first dispute settlement action against China in 2004, over allegedly discriminatory tax treatment provided in favour of domestically produced semiconductors. The case was resolved by a memorandum of understanding between the two countries in July 2004, before a WTO panel was constituted. To date,

the EU has not initiated WTO dispute settlement consultations with China. For its part, China has participated as an observer in many disputes raising issues relevant to its own trade interests, and could be expected to file its own requests for consultations before long.

Textiles and apparel

On 31 December 2004, the WTO Agreement on Textiles and Clothing (ATC) brought about the end of bilateral textile and clothing quotas that had initially been negotiated and governed under the Multifibre Agreement (MFA). The ATC, which covered all products subject to the MFA, was a transitional arrangement to eliminate quotas on a staged basis, with a goal of total liberalisation by 1 January 2005. While the expiration of quotas was welcomed by major producer countries, most particularly China, and by the retail sector around the world, many textile and apparel producers in the US and the EU and a number of smaller producer countries saw the end of the quota regime as a major threat to their production activities.

Fearful of the potential impact of an unrestrained China on the US textile and apparel market, the US made initial use of the special China textile safeguard in the fall of 2003, when it imposed safeguards on three categories of textile and apparel products. In late 2004, US producers requested safeguard measures on a range of textile and apparel categories, including many categories that were still restrained by quotas through 2004. These actions were based on Paragraph 242 of China's WTO Accession Treaty, which provides that if a member considers that imports of Chinese textiles or apparel covered by the ATC are "due to market disruption, threatening to impede the orderly development of trade in these products," it may "request consultations with China with a view to easing or avoiding such market disruption". Once a WTO member requests consultations with China, it may restrict imports in the specified category(ies). Action taken under these procedures can remain in effect for one year, renewable on reapplication.

US importers reacted by seeking to enjoin the US government from implementing a safeguard based only on the threat of market disruption. In late December, the US Court of International Trade (CIT) agreed with the importers, and issued a preliminary injunction that halted the US government from further consideration of the safeguards, pending CIT review. The ruling is currently on appeal.

Notwithstanding the US importers' successful efforts to prevent threat-based safeguards cases from moving forward, two recent developments suggest that safeguards cases—this time predicated on evidence of major import surges—are likely in 2005. First, the US Department of Commerce (DOC) announced that beginning in April 2005, it will release monthly preliminary textile and apparel import data several weeks in advance of the official Census data release—a move that will accelerate requests for safeguards based on first quarter 2005 data. Second, the Bush administration is reportedly willing to consider self-initiating cases against certain textile and apparel

imports from China in exchange for obtaining domestic industry support for the Central American Free Trade Agreement currently pending in the US Congress.

The end of quotas per the ATC has been just as politically sensitive in the EU as it has been in the US, where Chinese imports of certain ATC products already freed from quotas were growing substantially even before the end of 2004. China's exports have grown substantially (98.7 per cent over 2001–2003), though mainly at the expense of exports from other third countries, which have seen their share of the EU market decrease by 20 per cent from 2001 to 2003.

The EU has in place the necessary trade instruments to act should market disruption be demonstrated. The EU has a general safeguard, as well as a special textiles safeguard provision based on China's WTO accession provisions. In December 2004, the EU adopted a regulation instituting an automatic import licensing scheme that will expedite surveillance of textiles and clothing imports from China. A similar surveillance system for footwear imports, from all sources, was adopted in January 2005. Should the import surveillance under these regulations indicate a high level of growth suggestive of market disruption, the EU could then act under its safeguard instruments. By the end of March 2005, the Commission is expected to issue guidelines on procedures and criteria for how these provisions should operate. At that point, the first post-ATC safeguard request of the EU textile and clothing industry, filed in early March 2005, will be assessed under the new criteria.

Importantly, however, the EU is taking political actions to avoid the need for renewed quotas. China and the EU have set up a 'textiles dialogue' aiming at achieving a smooth transition to a quota-free textiles trade environment. The EU has also undertaken high-level multi-stakeholder consultations within the EU to arrive at a strategy for balancing a sustainable EU textiles industry with continuing export opportunities for China. Finally, it is acting at the multilateral level, notably within the current Doha round of WTO negotiations, to secure better market access for EU production in third countries, and to reduce tariffs and non-tariff barriers to EU exports. Recently, the EU stated that it would take safeguard measures only as a "last resort" and only on clear evidence that imports are causing serious distortion on the EU market. The broader EU aim is to implement a mix of policies that will establish an acceptable equilibrium beyond the initial surge of imports into the EU following the ATC liberalisation.

Use of import relief provisions

Anti-dumping duty actions

Historically, China has been the principal target of anti-dumping duty actions in both the US and the EU.¹ During the period from July 2003 to June 2004, for example, the WTO reports that the US initiated 42 anti-dumping proceedings, of which 13 involved China. Figures for the EU are comparable—of 17 anti-dumping proceedings initiated, six involved China. For each jurisdiction, more cases were initiated against China than any other single country.

In anti-dumping duty proceedings in both the US and the EU, China is treated as a 'non-market economy'. This designation is significant. In anti-dumping proceedings involving producers in market economy countries, administering authorities typically look to a producer's actual sales and cost information to calculate its dumping margin. In non-market economy cases, though, the producer's sales prices are rejected, as is its own production cost information, on the theory that these sales and cost data are distorted and unreliable. In lieu of these supposedly distorted data, the US and the EU use 'surrogate values' for the calculation of the 'normal value' to which the export price is then compared. These surrogate values are generally based on data from a country deemed to be at a level of development comparable to that of China. For the US, that country

is almost always India; the EU uses a number of criteria which result in more varied surrogate country decisions. In defence of this seemingly arbitrary system, domestic producers argue that the use of surrogate values is necessary to counteract distortion in the Chinese economy and to offset the effect of government subsidies that are generally available throughout China. Chinese producers counter that this methodology is simply designed to produce unpredictable and often unrealistically high dumping margins. While a change to China's non-market economy status is not expected in the US, the EU has very recently announced that it will again review China's non-market economy status. Indeed, a recent EU provisional measure granted market economy status to 25 of 49 exporters who applied, the first time so many Chinese companies have been given this designation. At a minimum, this may herald the start of less-stringent application of the EU criteria.

In the US, two of the largest anti-dumping cases against Chinese imports were conducted in 2004, with dramatically different results. In the first, involving wooden bedroom furniture, six of the eight companies individually investigated received dumping margins under 10 per cent. Moreover, the rate applicable to 115 companies that were not individually investigated, but which were able to demonstrate their independence from the central Chinese government—the so-called 'Section A' companies, named for the portion of the questionnaire they were required to complete—was a relatively low 6.65 per cent. By contrast, in the anti-dumping duty investigation against shrimp, the US individually investigated four companies. While one was found not to have dumped, the remaining three had dumping margins ranging from 27.89 to 82.27 per cent, with a Section A rate of 53.68 per cent. While bedroom furniture and shrimp are obviously very dissimilar products, the dramatic differences in the dumping margins lends credibility to the argument that the surrogate value methodology leads to a high degree of unpredictability in non-market economy anti-dumping duty proceedings.

Relief from 'market disruption'

In response to China's accession to the WTO, the US passed a China-specific import relief measure designed to counteract import surges that were expected with the lowering of US tariffs on Chinese products. Under Section 421 of the Trade Act of 1974 (19 USC § 2451), a US industry can seek relief from Chinese imports if it can demonstrate that imports from China have increased and threaten to cause "market disruption," which occurs when imports "are increasing rapidly, either absolutely or relatively, so as to be a significant cause of material injury, or threat of material injury, to the domestic industry". If the US International Trade Commission (ITC) makes an affirmative determination, it will make a recommendation for relief to the president, who can then impose relief unless he concludes that the imposition of relief is not in the "national economic interest".

On its face, this particular statute would appear to be tailor-made for US companies harmed by increasing Chinese imports. In reality, though, this provision has been seldom used. To date, only five cases have been filed under this provision, and none have resulted in the imposition of import relief. In three of these cases, while the ITC voted in favour of relief for the domestic industry, the president denied relief on grounds of national economic interest. This track record suggests that domestic industries are unlikely to avail themselves of this provision in the future, perhaps with the exception of the most significant, politically-charged trade cases, such as textiles and apparel. This also suggests that for most cases, anti-dumping relief is likely to remain the remedy of choice for US producers who believe themselves harmed by allegedly unfair Chinese import competition.²

Political considerations

In both the US and the EU, China remains the primary target for legislators who, often in response to constituent pressures, seek to punish China for its role, real or perceived, in the decline of domestic manufacturing activities.

In the US, the overriding concern has been the alleged 'manipulation' of the renminbi value by the Chinese government. As a consequence, several members of the US Congress support legislation to impose a 27.5 per cent tariff on all imports from China, a tariff supposedly calculated to offset this currency manipulation. While this legislation has little chance of passage, it demonstrates the level of frustration in the US with China's monetary policy, and signals the possibility for a high-level confrontation on this issue. However, it is notable that while the current administration claims to be taking a tough position on currency manipulation, it also rejected a petition filed under Section 301 of the Trade Act of 1974 (19 USC § 2411) alleging currency manipulation that, if successful, would have allowed the US to impose punitive tariffs against Chinese imports. This suggests that the current administration intends to address the issue of currency manipulation through government-to-government negotiations that take into account broader economic and political issues, rather than through a US legal process that would focus more on domestic interests and concerns perhaps with less flexibility.

In the EU, political attention has focused on the fact that China has become the EU's second-largest trading partner, after the US. This new trade situation has been accompanied by recognition that relations with China need to be enhanced at all levels and in multiple areas, and China and EU leaders have agreed to actively explore the feasibility of a new framework agreement covering the EU's relations with China. Not surprisingly, the European Commission believes that, amongst other things, such framework should include "ambitious" provisions on trade and investment.

Conclusion

Up to now, China has made a more or less orderly transition into the international trading community. With its accession to the WTO, China has demonstrated a willingness to make hard choices and to

make difficult changes to its domestic legal structure. Moreover, the relatively few disagreements that have occurred between the US and the EU on the one hand and China on the other have been resolved largely without turmoil. The relative lack of major trade disputes is no doubt due in part to the fact that China continues to consume raw materials, most especially steel, at a phenomenal rate. To be sure, elements in both the US and the EU continue to place blame on China as an unfair trader in order to seek retaliation, but to date, these efforts have had little real impact.

The future is less clear. For example, the coming textile and apparel fight in both the US and the EU will be a test to see how far China is willing to go to avoid a confrontation with its main western trading partners. While continued self-restraint by China could avoid a major confrontation, China may also reasonably expect to take advantage of the benefits of the WTO trading system they negotiated in 2001. We would expect to see some type of legal process in 2005 aimed at restricting Chinese textile and apparel imports, and perhaps some political resolution of this issue thereafter.

The bigger concern arises from the fact that, like all economies, China's will eventually cool, even assuming some government intervention. When that occurs, China's manufacturers will undoubtedly begin to look abroad for export opportunities to replace their lost domestic sales. When that occurs, we could expect to see trade frictions grow, as Western manufacturers seek to protect themselves against perceived unfair trade practices by China. The resulting pressures are likely to be a true test of the ability of the US and the EU to manage their important trade relationships with China.

- 1 Anti-dumping duties are imposed when a product has been sold in a jurisdiction at less than its 'normal value', as that term is defined under domestic and international law, and when imports of that product have injured (or threaten to injure) an industry in that jurisdiction producing a comparable product.
- 2 Legislation has been introduced recently in the US Congress to extend the countervailing duty law (ie anti-subsidy law) to Chinese imports, to which it is currently inapplicable, but the chances of success of this legislation are not clear.

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