

A PRIVATE BARGAINING AND EFFICIENT BREACH APPROACH TO THE PROBLEM OF U.S.-CHINA TRADE: BRINGING A NON-VIOLATION CASE IN THE WTO

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When Joe Biden defeated Donald Trump to become U.S. president in 2020, many observers hoped that Biden would reset the troubled U.S.-China trade relationship. The Trump administration had abandoned the rules-based approach to international trade of the World Trade Organization (WTO) and adopted a power-based approach instead. Using a power-based approach, the United States imposed or threatened sanctions if China did not dismantle its state-led economy and terminate the use of industrial subsidies to support its domestic industries. The United States also crippled the dispute settlement system of the WTO so that nations could not challenge U.S. belligerence in the WTO. A power-based approach uses threats and sanctions in blatant disregard of WTO rules to bully U.S. trading parties into trade concessions. Such an approach is a return to the law of the jungle and vigilante justice.

Two years into Biden's term, rather than a reset, the Biden administration has retained most of the Trump era China policies, maintaining a precarious status quo. At present, the Biden administration has no clear China strategy of its own and no clear path forward to challenge China's state-led economy.

This Article proposes a new strategy for the United States: bring a non-violation case against China in the WTO. Unlike a violation case, a non-violation case does not assert a breach of any of the textual provisions of the WTO. The non-violation case asserts that China has used its state-led policies to deny the United States the benefits of China's WTO membership. Under a non-violation case, the United States and China may be able to reach a private bargain under which China can maintain its state-led economy but will compensate the United States for any harm caused, an efficient breach solution. The approach in this Article has the advantage of being a return to the rules-based approach of the WTO and will also allow China and the United States to reach a private bargain to resolve the longstanding problem of China's industrial subsidies.

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I. INTRODUCTION

When Joseph R. Biden defeated Donald J. Trump for the U.S. presidency in 2020, many hoped that Biden would reset the U.S.-China trading relationship after the turbulent years of the Trump administration.¹ Yet, nearly two years into the Biden presidency, the U.S.-China relationship has not undergone a reset but a pause instead.² Biden has left in place nearly all of the Trump era trade policies towards China, choosing to maintain the status quo while the United States mulls its next steps in its trade policy with China.³ Maintaining the status quo of the

¹ Typical of these views are Rethink, Reset, Recalibrate: U.S.-China Relations from Donald Trump to Joe Biden (Mar. 16, 2021), [https://www.americanacademy.de/event/rethink-reset-recalibrate-u-s-china-relations-from-donald-trump-to-joe-biden/Will US-Chinas Relations Shift under Biden? China Seems to Think So](https://www.americanacademy.de/event/rethink-reset-recalibrate-u-s-china-relations-from-donald-trump-to-joe-biden/Will%20US-Chinas%20Relations%20Shift%20under%20Biden?China%20Seems%20to%20Think%20So), AllianceBernstein (Nov. 17, 2020), [https://www.alliancebernstein.com/corporate/en/insights/economic-perspectives/will-us-china-relations-shift-under-biden-china-seems-to-think-so.html](https://www.americanacademy.de/event/rethink-reset-recalibrate-u-s-china-relations-from-donald-trump-to-joe-biden/https://www.alliancebernstein.com/corporate/en/insights/economic-perspectives/will-us-china-relations-shift-under-biden-china-seems-to-think-so.html).

² The report on China’s WTO compliance by Katherine Tai, the United States Trade Representative under the Biden administration, and the report by Robert Lightziger, the USTR under the Trump administration, reach the same conclusions and are also similar in tone and content. Cf. United States Trade Representative, 2021 Report to Congress on China’s WTO Compliance (Feb. 2022), [https://ustr.gov/sites/default/files/files/Press/Reports/2021 USTR% 20ReportCongressChinaWTO.pdf](https://ustr.gov/sites/default/files/files/Press/Reports/2021%20USTR%20ReportCongressChinaWTO.pdf) (hereinafter “USTR 2021 Report”) with United States Trade Representative, 2020 Report to Congress on China’s WTO Compliance (Jan. 2021). See also Alex Leary and Bob Davis, Biden’s China Policy is Emerging – and it Looks a Lot Like Trump’s, *Wall St. J.* (June 10, 2021), <https://www.wsj.com/articles/bidens-china-policy-is-emergingand-it-looks-a-lot-like-trumps-11623330000>. Jennifer Conrad, A Year In, Biden’s China Policy Looks a Lot like Trump’s (Dec. 30, 2021), <https://www.wired.com/story/biden-china-policy-looks-like-trumps/>.

³ *Id.* The Biden administration is considering lifting some Trump era tariffs, but no final decision has been made as there are disagreements within Biden’s cabinet. Yuka Hayashi, Biden Might Soon Ease Chinese Tariffs, in a Decision Fraught with Policy Tensions, *WALL ST. J.* (July 4, 2022), <https://www.wsj.com/articles/biden-might-soon-ease-chinese-tariffs-in-a-decision-fraught-with-policy->

Trump era policies, however, leaves the global trading system and the economic and trade relationship with China in an uneasy, precarious state.

Under the Trump administration, the United States abandoned all pretense of following the rules of the multilateral trading system established seventy-five years ago by the World Trade Organization (WTO) and its predecessor the General Agreement on Tariffs and Trade (GATT).⁴ Instead, the United States adopted a unilateral and power-based approach to international trade. The United States asserts that it will follow only those GATT/WTO obligations with which it agrees and will repudiate or ignore GATT/WTO obligations inconsistent with U.S. interests.⁵ The Trump administration shocked the global trading community, including some its closest trading partners, by imposing punitive new tariffs on all imports of steel and aluminum from any country based upon a dubious rationale that is inconsistent with the GATT/WTO.⁶

As part of its power-based approach, the Trump administration also crippled the dispute settlement system of the WTO by paralyzing the WTO Appellate Body so that other WTO members can no longer challenge U.S. actions in the WTO.⁷ The result of this U.S. blockade of the Appellate Body, also maintained by the Biden administration, is that all WTO obligations are, in effect, no longer enforceable.⁸ Any nation that loses a case in the first instance at the panel stage in the WTO can nullify the decision by appealing it to the now decommissioned Appellate Body.⁹ Once an appeal is lodged, no decision can become legally effective until the appeal is concluded;¹⁰ as the paralyzed Appellate Body cannot convene, the appeal cannot be concluded so the decision is suspended in a legal limbo.¹¹ The losing party in the panel decision can now

tensions-11656927001. Not only has the Biden administration left in place many Trump era China policies, but the Biden administration has also maintained the Trump paralysis of the WTO Appellate Body, an attack on the WTO that has left it in a life or death crisis. See Part II.D infra.

⁴ The General Agreement on Tariffs and Trade was a 1947 treaty designed to lower tariff barriers that was to be administered by the International Trade Organization (ITO). Due to opposition by the U.S. Congress, the ITO never came into existence. When the WTO was established in 1995, the WTO assumed the role originally intended for the ITO. The GATT 1947 was republished as the GATT 1994, which is in force currently. See Daniel C.K. Chow, Thomas J. Schoenbaum, and Gregory Dorris, *INTERNATIONAL TRADE LAW: PROBLEMS, CASES, AND MATERIALS* 10-11 (4th ed. 2022) (hereinafter “Chow, Schoenbaum, and Dorris, *INTERNATIONAL TRADE LAW*”).

⁵ See Daniel C.K. Chow, *United States Unilateralism and the World Trade Organization*, 37 *B.U. INT’L L. J.* 1, 5-10 (2019).

⁶ *Id.* at 19-21.

⁷ See Daniel C.K. Chow, *A New and Controversial Approach to Dispute Resolution under the 2020 United States China Trade Agreement*, 26 *HARV. NEG. L. REV.* 31, 50 (2020) (hereinafter “Chow, *Dispute Resolution under the 2020 USCTA*”).

⁸ *Id.* at 51.

⁹ *Id.* at 50-51.

¹⁰ Article 16.4 of the WTO Dispute Settlement Understanding (1994) (DSU) provides “If a party has notified its decision to appeal, the report by the panel shall not be considered for adoption by the DSB [Dispute Settlement Body] until after the completion of the appeal.” Until a decision is adopted by the DSB, the decision has not legal effect. Thus, if a panel decision has been appealed the decision becomes frozen in a state of indefinitely suspension and becomes a legal nullity.

¹¹ DSU, Art. 16.4.

ignore it as it has become a legal nullity.¹² As a result of this U.S.-instigated crisis, the WTO now finds itself imperiled and its future survival at stake.¹³

The United States reserved some of its most belligerent tactics for its chief antagonist the People's Republic of China (PRC or China) by imposing or threatening to impose draconian tariffs on virtually all imports from China.¹⁴ When China responded with retaliatory tariffs on U.S. goods, the relationship between the two nations spiraled into a destructive trade war.¹⁵ The two nations reached a truce when they signed Phase I of the United States Economic and Trade Agreement (USCTA) on January 15, 2020.¹⁶ In exchange for the U.S. suspension of new tariffs, China agreed to purchase \$200 billion in U.S. goods and services over a two period,¹⁷ and made other commitments, including many in the area of intellectual property protection.¹⁸ The USCTA also established a dispute resolution process for USCTA and WTO disputes that is completely under the control of the United States, ensuring that the United States will never lose another trade dispute with China.¹⁹

As the Biden administration continues to develop its trade policy towards China, U.S. concerns about China remain just as serious as those that previous U.S. administrations have held ever since China joined the WTO in 2001. Since China's accession to the WTO, the United States has consistently asserted that China has reneged on its obligations to dismantle its state-led economy and embrace free market reforms, which was a condition of its WTO membership.²⁰ Instead, the Chinese Communist Party, China's leaders, has tightened its control over the

¹² *Id.*

¹³ *Id.*

¹⁴ Daniel C.K. Chow, *U.S. Trade Infallibility and the Crisis of the World Trade Organization*, 2020 MICH. ST. L. REV. 599, 600-01 (2020) (hereinafter "Chow, U.S. Trade Infallibility").

¹⁵ Chad Bown and Melina Kolb, *Trump's Trade War Timeline: an Up-to-Date Guide* (June 21, 2022), <https://www.piie.com/blogs/trade-investment-policy-watch/trump-trade-war-china-date-guide>.

¹⁶ Economic and Trade Agreement between the Government of the United States of American and the Government of the People's Republic of China, https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/Economic_And_Trade_Agreement_Between_The_United_States_And_China_Text.pdf.

¹⁷ USCTA, *supra* note 16, Art. 6.2 ("During the two-year period from January 1, 2020 through December 31, 2021, China shall ensure that purchases and imports into China from the United States of the manufactured goods, agricultural goods, energy products, and services identified in annex 6.1 exceed the corresponding 2017 baseline amount by no less than \$200 billion.") The United States argues that China has failed to fulfill these commitments.

¹⁸ Chapter 1 of the USCTA deals with intellectual property issues and contains China's commitments on enhanced protection for trade secrets and confidential business information (Arts. 1.1-1.19), pharmaceuticals and pharmaceutical ingredients (Arts. 1.10-1.11), piracy on e-commerce platforms (Arts. 1.13-1.14), geographic indications (Arts. 1.15-1.17), counterfeit goods (Arts. 1.13-1.14, 1.18-1.23), bad-faith trademarks (Arts. 1.24-1.25), judicial enforcement (Arts. 1.26-1.31), and bilateral cooperation on intellectual property protection (Arts. 1.32-1.33).

¹⁹ Chow, *Dispute Resolution under the 2020, USCTA*, *supra* note 7, at 51-53. The USCTA dispute resolution mechanism applies not only to USCTA disputes but also to WTO disputes. *Id.* at 59-61.

²⁰ Daniel C.K. Chow, *The Myth of China's Open Market Reforms and the World Trade Organization*, 41 U. PENN. J. INT'L L. 939, 943-44 (2020) (hereinafter "Chow, *The Myth of China's Open Market Reforms*").

economy and has implemented many interventionist domestic policies that harm the United States.²¹ Among the most serious U.S. concerns are that China uses a myriad of non-transparent domestic policies to funnel industrial subsidies and to grant favorable treatment to Chinese business entities, including its state-owned enterprises (SOEs), business units under the ownership of the state.²² These subsidies allow China to export lower price goods to the United States, harming U.S. industries and consumers.²³ Lower priced Chinese domestic goods, sustained by subsidies, also act as an import barrier that prevent U.S. goods from entering the Chinese domestic market.²⁴ The Trump administration had planned to address subsidies and SOEs in Phase II of the USCTA, but the Biden administration has indicated that a Phase II agreement will not be forthcoming.²⁵ Katherine Tai, the United States Trade Representative under the Biden administration, also claims that using the WTO dispute settlement system is not useful because it cannot address the type of internal non-market domestic policies and structural issues at the heart of the China subsidies problem.²⁶ These positions of the Biden administration leave the United States without a current strategy for addressing these longstanding U.S. concerns about China’s use of industrial subsidies and other non-market domestic policies.

This Article explains a strategy that the United States can adopt and use to challenge China’s interventionist and non-market policies against this background of uncertainty and turbulence in the U.S.-China economic relationship. The key to this approach is that the United States should launch a “non-violation case” against China’s use of subsidies and other non-market policies in the WTO dispute settlement system.²⁷ The GATT/WTO distinguishes between a “violation case” that asserts a breach of a textual provision of the WTO agreements and a non-violation case that asserts that a benefit has been denied by actions of a nation although no violation of a textual provision has occurred.²⁸ One major advantage of a non-violation case is that the parties can bargain for a mutually satisfactory solution to the dispute.²⁹ Such bargaining is not possible under a violation case since the losing party in such a case has a fundamental

²¹ *Id.* at 944.

²² USTR 2021 Report, *supra* note 2, at 3.

²³ *Id.* at 10. Subsidies Chinese exports to the United States harm competing U.S. industries due to the artificial price support for the exports. Consumers may also be harmed because the Chinese exporter, once it drives out local competitors, might raise the price of its goods or lower the quality. For a fuller discussion, see Part III.C.2 *infra*.

²⁴ *Id.*

²⁵ Demetri Sevastopulo and Aime Williams, *FIN. TIMES* (Oct. 2, 2021) (noting that U.S. “was not preparing to start ‘phase 2’ negotiations”), <https://www.ft.com/content/9bb00532-8818-448d-a92f-b5cba0b19fae>.

²⁶ USTR 2021 Report, *supra* note 22, at 14.

²⁷ The non-violation case is recognized in GATT Article XXIII (“Nullification and Impairment”). A fuller discussion of Article XXIII and the non-violation case is set forth in Part III.D *infra*.

²⁸ GATT, Art. XXIII:1(a) (violation case), Art. XXIII:1(b) (non-violation case). These terms are not contained in the GATT provision, but have been so designated under GATT jurisprudence. See also the discussion in Part III.D *infra*.

²⁹ DSU, *supra* note 10, Art. 26:1(b) (noting that once a non-violation claim has been established, the parties should reach a “mutually satisfactory solution”). For a fuller discussion of this point, see Part III.D *infra*.

obligation to cure its breach of a textual provision. China has already accepted such a private bargaining approach under the USCTA, which can be viewed as a bargain reached by the parties for China to compensate the United States for China's market access issues. The USCTA, however, is outside the WTO so it is a bargain in the shadow of the law. A non-violation case will allow the parties to reach a private bargain within the confines of the rules-based WTO system.

Within the larger overall context of a long term U.S.-China trade relationship, the approach suggested by this Article also has at least three major advantages as follows:

First, bringing a non-violation case against China is not part of a power-based approach but is a return to the rules-based multilateral approach of the GATT/WTO. We believe that the Trump administration's power-based approach towards trade with China is not a viable or sustainable long term strategy. A power-based approach rejects the economic logic of the GATT/WTO, which provides an optimal solution to the terms-of-trade prisoner's dilemma, i.e. a dilemma in which two countries acting selfishly will reach a suboptimal solution on tariffs and fail to cooperate on low tariffs even when it is in their best interests to do so.³⁰ In the absence of a trade agreement, the outcome of the prisoner's dilemma is for a country to set a high tariff no matter how low the tariff set by the other country.³¹ Under the trade agreements of the GATT/WTO, however, countries have an incentive to agree to low tariffs; the successful history of the GATT/WTO has resulted in the lowest tariffs in world history.³² A non-violation case will allow the parties to reach an optimal solution to the prisoner's dilemma of U.S.-China trade.³³

The power-based approach of the United States has already resulted in a far higher level of U.S.-China tariffs by both countries than under their WTO commitments.³⁴ Under a power-based approach, the response of the United States is to use the threat of trade sanctions, given credence by its economic power, to bully China and other countries into trade concessions.³⁵ But unlike smaller economies, China is not capitulating to U.S. pressure without a fight but has imposed retaliatory tariffs inflicting pain on the United States.³⁶ Because the United States has the larger and more powerful economy, the United States might achieve short term gains from China by using a power-based approach, but what will happen when China assumes the mantle

³⁰ See Part IV.A *infra*. The classic prisoner's dilemma posits two prisoners who are held by the police in different cells and cannot communicate with each other. The police offer the suspects the opportunity to remain silent or to blame the other for the crime. If they remain silent, they will each serve one year in jail. If they both blame each other, they will spend three years in jail. If one of the suspects blames the other and the other remains silent then the prisoner who remains silent will serve five years in jail. In a situation where one prisoner does not know the decision by the other, the most rational choice is to blame the other even the optimal solution is for both to remain silent. See Prisoner's Dilemma, Corporate Finance Institute. <https://corporatefinanceinstitute.com/resources/knowledge/other/prisoners-dilemma/>. A similar problem can arise in the context of international trade.

³¹ See Part IV.A *infra*.

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ See Part III *infra*.

³⁶ *Id.*

of the top economic power in the world as is widely predicted to occur in the near future?³⁷ Then it may become China's turn to use a power-based approach to bludgeon the United States into submission. A power-based approach is a return to the law of the jungle and vigilante justice; it is not a long term substitute for the rules-based approach followed by the GATT/WTO for the past seventy years.

Second, a non-violation claim, as suggested here, allows the United States to address China's domestic policies that support the use of industrial subsidies. Violation cases under the texts of GATT/WTO deal in general with border measures, i.e. tariffs or quotas, and do not generally address a member's domestic policies.³⁸ The advantage of a non-violation case follows from the WTO's acknowledgment that the WTO is an incomplete agreement that deals only with shallow integration of border measures but not with issues at the deeper level of domestic policy.³⁹ The non-violation case allows the United States to assert the claim that China's domestic non-market policies have denied the United States the benefits of China's WTO membership. This will allow the United States to challenge China's domestic policies, which would not be possible under a violation case. As noted above, the non-violation case will also allow the parties to bargain and reach a mutually satisfactory solution. Such a solution might be to allow China to maintain its domestic policies but to compensate the United States with improved market access, commitments by China to buy more U.S. products and services, a combination of both, or some other mutually agreeable solution. In other words, a non-violation case might result in an efficient breach by China of its WTO obligations as a solution to the problem of China's industrial subsidies. This approach acknowledges the reality that China is deeply committed to its state-led economy and no demands by any nation or the WTO is likely to convince China to change course.⁴⁰

Third, the suggested approach of bringing a non-violation case in the WTO dispute settlement system is possible even in light of the United States' crippling of the WTO Appellate Body. The suggested approach in this Article is for the United States join with Japan and the European Union as parties to the non-violation case. A joint case may be possible as the United States, Japan, and the EU have formed an alliance to contest China's non-market policies.⁴¹ A case involving the United States, EU, Japan, and China – the four most powerful economies in the world — should lead to political benefits in the WTO as it will be a high-profile case that

³⁷ Nicolas Rapp and Brian O'Keefe, This Chart Shows How China will Soar Past the U.S. to Become the World's Largest Economy by 2030, *Fortune* (Jan. 30, 2022), <https://fortune.com/longform/global-gdp-growth-100-trillion-2022-inflation-china-worlds-largest-economy-2030/>.

³⁸ See Part V.A *infra*.

³⁹ *Id.*

⁴⁰ Chow, *The Myth of China's Open Market Reforms*, *supra* note 19, at 974-75.

⁴¹ United States, Europe, and Japan: Trilateral Cooperation in the Indo-Pacific, Center for Strategic and International Studies, <https://www.csis.org/events/united-states-europe-and-japan-trilateral-cooperation-indo-pacific> (discussing the experience of the United States, EU, and Japan in balancing China's economic and military strength in the Indo-Pacific region); Bernard M. Hoekman and Douglas R. Nelson, From EU-Japan-US Trilateral to a Plurilateral Initiative on Subsidies (Aug. 2021), <https://cadmus.eui.eu/handle/1814/72218> (noting the rise of China calls for international cooperation for new rules on the use of domestic subsidies).

will demand attention from all WTO members. The case will focus attention on the fundamental contradictions between China's state-led economy and the free market approach of the WTO.

Adding the EU will also bring the case within the jurisdiction of the Multiparty Interim Appeal Arbitration Arrangement (MPIA), which creates an interim Appellate Body to hear appeals while the crisis of the WTO Appellate Body is being resolved.⁴² As both the EU and China are members of the MPIA, the dispute falls within the MPIA so long as two members (the EU and China) are on opposite sides of the case — even though it also involves two non-members, the United States and Japan.⁴³ As detailed in a subsequent section, if the United States wins in the panel, the MPIA prevents China from using appeals to the paralyzed WTO Appellate Body to nullify any panel decision in favor of the United States.⁴⁴ If China loses the non-violation case in the panel, China must file any appeals to the MPIA Interim Appellate Body and must abide by its decision.⁴⁵

This Article proceeds as follows. Part II of this Article will discuss China's WTO accession and its commitments to dismantle its state-led economy. Part II will also set forth the basic GATT/WTO legal framework used to discipline the granting of industrial subsidies, the main concern of the United States. Part II will also set out the legal distinctions between violation and non-violation cases under the GATT/WTO. Part II argues that the United States has the legal basis to proceed with a non-violation case against China and that it has major advantages over a violation case. Part III then examines the power-based approach to international trade used by the Trump administration. Part IV examines the economic logic of the GATT/WTO and the solution it provides to the prisoner's dilemma in international trade and its success in lowering world tariffs. A power-based approach undermines the economic logic of the GATT/WTO that has been successful in reducing trade barriers for the past seventy five years since the founding of the GATT. Part V explains why China's domestic policies are difficult to address under the GATT/WTO, which focuses on integration at the level of trade and trade remedies, a form of shallow integration as the GATT/WTO does not require integration at the level of domestic industrial policies. Part VI explains the economic basis for a non-violation claim and how such a claim will allow the parties to bargain for an efficient outcome to the U.S.-China trade prisoners' dilemma.

II.

CHINA, STATE-OWNED ENTERPRISES, AND THE WTO

A. China, Free Market Reforms, and the WTO

⁴² Multi-Party Interim Appeal Arbitration Arrangement Pursuant to Article 25 of the DSU, https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158685.pdf.

⁴³ MPIA, *supra* note 42, Art. 9, Arts. 1-2. For a fuller discussion, see Part III.D *infra*.

⁴⁴ Part III.D.3 *infra*.

⁴⁵ Of course, China might win the appeal but that would depend on the merits of its arguments. The main point, however, is that once the case is under the MPIA, China cannot simply file an appeal to the decommissioned WTO Appellate Body and nullify the panel decision.

When China became a WTO member in 2001, the United States, having played a key role in China's successful bid, was full of optimism and hope for the future of the U.S.-China relationship.⁴⁶ During its bid, China was still under the shadow of the shocking events at Tiananmen Square when the People's Liberation Army crushed popular protests for democratic reform.⁴⁷ WTO membership for China would have been impossible without U.S. backing but China enjoyed the ardent support of the U.S. President, Bill Clinton.⁴⁸

President Clinton helped convince Congress to support China's WTO bid by claiming that China would embrace free market reforms and dismantle its state sector as a result of WTO membership.⁴⁹ Striking a responsive chord with China's human rights critics in Congress, Clinton drew a link between economic freedom and political freedom.⁵⁰ Clinton argued that by agreeing to WTO membership, "China is not simply agreeing to import more of our products; it is agreeing to import one of democracy's most cherished values: economic freedom. [T]he more China liberalizes its economy, the more fully it will liberate the potential of its people . . . and when individuals have the power not just to dream but to realize their dreams, they will demand a greater say."⁵¹

Clinton then delivered what might have been the clinching argument for the China skeptics in Congress: China might even eventually shed the chains of communism! Clinton proclaimed, "[China] will find that the genie of freedom will not go back into the bottle. As Justice Earl Warren once said, liberty is the most contagious force in the world . . . I understand that this is not in and of itself a human-rights policy. But still, it is likely to have a profound impact on human rights and political liberty."⁵²

In the face of such audacious claims by the U.S. president, China, perhaps heeding the words of Deng Xiaoping, one of its most influential leaders, stood by calmly and made no bold promises.⁵³ A review of China's Protocol of Accession to the WTO and other accession documents reveals that China never promised to dismantle its state sector or to ever submit itself

⁴⁶ See Tom Cotton, Senator for Arkansas, China's Entrance into the WTO was a 'Disaster' for the American Economy, Dec. 8, 2021, <https://www.cotton.senate.gov/news/speeches/chinas-entrance-into-the-wto-was-disaster-for-the-american-economy> ("Twenty years ago this week, the People's Republic of China became a member of the World Trade Organization. And there was great rejoicing across Washington by lobbyists, politicians, and bureaucrats, and for that matter among corporate CEOs and Wall Street bankers[.]").

⁴⁷ Tiananmen: Another Bump in China's Road to WTO Accession, Association for Diplomatic Studies & Training, <https://adst.org/2016/04/tiananmen-another-bump-in-chinas-road-to-wto-accession/> (discussing China's WTO negotiations and noting that "progress was hobbled by . . . world reaction to the brutal repression of protests in Tiananmen Square on June 4, 1989")

⁴⁸ Cotton, *supra* note 46.

⁴⁹ Chow, *The Myth of China's Open Market Reforms*, *supra* note 20, at 957.

⁵⁰ President Bill Clinton, Speech on China Trade Bill (Mar. 9, 2000), https://www.iatp.org/sites/default/files/Full_Text_of_Clinton_Speech_on_China_Trade_Bi.htm.

⁵¹ *Id.*

⁵² *Id.*

⁵³ Deng Xiaoping cautioned that when enmeshed in critical times and events: "Keep a cool head and maintain a low profile. Never take the lead – but aim to do something big." 26 Top Deng Xiaoping Quotes, <https://quotes.thefamouspeople.com/deng-xiaoping-4263.php>.

to a legal obligation to do so.⁵⁴ China only promised to implement some market reforms within an overall framework of a state-controlled economy.⁵⁵ If China is guilty of anything, it is in doing nothing to dispel Clinton's grandiose dream that the Chinese Communist Party (CCP or Party) would voluntarily relinquish power, a prospect that is contradicted by over 2,000 years of Chinese history.⁵⁶ To this day, however, the United States repeatedly asserts otherwise: that China has reneged on its promises and obligations to dismantle its state-led economy as a condition of WTO membership. According to the USTR for the Biden administration in her 2022 report to Congress:

After 20 years of WTO membership, China still embraces a state-led, non-market approach to the economy and trade, despite other WTO members' expectations – and China's own representations – that China would transform its economy and pursue the open, market-oriented policies endorsed by the WTO. In fact, China's embrace of a state-led, non-market approach to the economy and trade has increased rather than decreased over time, and the mercantilism that it generates has harmed and disadvantaged U.S. companies and workers, often severely.⁵⁷

The United States claims that a major feature of China's state-led economy is the use of government subsidies:

China pursues a wide array of continually evolving interventionist policies and practices. It offers substantial government guidance, resources and regulatory support to Chinese industries. At the same time, it also seeks to limit market access for imported goods and services and restrict the ability of foreign manufacturers and services suppliers to do business in China in various ways.⁵⁸

U.S. frustration and dissatisfaction with China's non-market policies led the Trump administration in 2018 to impose punitive tariffs on imports from China, which retaliated with punitive tariffs of its own on U.S. goods. To avert a trade war, on January 15, 2020, the United States and China signed the U.S.-China Economic and Trade Agreement (USCTA), under which China made a commitment to purchase \$200 billion in goods and services from the United States over a two-year period. A second agreement, Phase II of the USCTA, was intended to address China's use of industrial subsidies and market access, among other contentious issues.⁵⁹

⁵⁴ Chow, *The Myth of China's Open Market Reforms*, *supra* note 20, at 960-64.

⁵⁵ *Id.*

⁵⁶ See Daniel C.K. Chow, *THE LEGAL SYSTEM OF CHINA IN A NUTSHELL* 121 (3d ed. 2015) (hereinafter "Chow, *THE LEGAL SYSTEM OF CHINA*").

⁵⁷ USTR 2021 Report, *supra* note 2, at 2.

⁵⁸ *Id.* at 7.

⁵⁹ See Jessica Bursztynsky, *Trump Trade Advisor Peter Navarro Lists What the US Wants from China in 'Phase Two' Trade Deal*, CNBC (Jun. 16, 2020), <https://www.cnbc.com/2020/01/16/peter-navarro-lists-us-demands-from-china-in-phase-two-trade-deal.html>.

After Joe Biden defeated Trump in 2020 for the U.S. Presidency, the Biden administration indicated that Phase II would not be forthcoming.⁶⁰ The lack of a Phase II agreement means that China's non-market policies and the subsidies issue will not be the subject of a trade agreement for the foreseeable future.

B. The Problem of China's State-Owned Enterprises

For the United States, one of the most problematic aspects of China's state-led economy is the outsized role played by China's SOEs.⁶¹ An SOE is a business entity that is owned in whole or in part by the State and in which the State injects capital.⁶² At the central level, the State Owned Assets Supervision and Administration Commission (SASAC) acts as a holding company and is the controlling shareholder of all SOEs in China.⁶³ The PRC has established a different entity, the Central Huijin Investment (CHI) Company that serves as the controlling shareholder of all of China's state-owned banks.⁶⁴ Although SASAC and CHI are government entities, they do not have authority to direct SOEs in conducting business. China claims that SOEs are autonomous and independent from government control. According to Xiao Yaqing, then chairman of the SASAC, "State-owned enterprises are independent market players. They are self-operated, self-financed, self-sustained, self-disciplined and self-developed."⁶⁵

Although SOEs are not subject to government control, SOEs are subject to the control of the CCP.⁶⁶ All SOEs have a dual management structure: a corporate management structure and a parallel party structure with the same persons holding positions at the equivalent level.⁶⁷ In this parallel structure, the Party position is always supreme. For example, the General Manager or the CEO, the top corporate position of an SOE, will also be the Party Secretary for the Party cell within the SOE.⁶⁸ By installing Party members in key positions in SOEs, the Party is able to control SOEs.⁶⁹ The CCP uses the same approach to control the PRC government.⁷⁰ The CCP is

⁶⁰ Demetri Sevastopulo and Aime Williams, FIN. TIMES (Oct. 2, 2021) (noting that U.S. "was not preparing to start 'phase 2' negotiations"), <https://www.ft.com/content/9bb00532-8818-448d-a92f-b5cba0b19fae>.

⁶¹ USTR 2021 Report, *supra* note 2, at 3.

⁶² Article 64, PRC Company Law (2018). See also Daniel C.K. Chow, *How China Promotes State-Owned Enterprises at the Expense of Multinational Companies in China and Other Countries*, 41 N.C. J. INT'L L. 455, 466 (2016).

⁶³ Chow, *The Myth of China's Open Market Reforms*, *supra* note 19, at 966.

⁶⁴ *Id.*

⁶⁵ Amanda Lee, *China Says State-Owned Enterprises are "Independent Market Players,"* SOUTH CHINA MORNING POST (Mar. 9, 2019), <https://www.scmp.com/economy/china-economy/article/2189348/china-says-state-owned-enterprises-are-independent-market>.

⁶⁶ Chow, *The Myth of China's Open Market Reforms*, *supra* note 20, at 969-70.

⁶⁷ *Id.*

⁶⁸ All companies must have a Party Organization within the company. See Article 19, PRC Company Law (2018).

⁶⁹ Chow, *The Myth of China's Open Market Reforms*, *supra* note 20, at 970.

⁷⁰ *Id.*

not a government entity, however; it is a political party so while SOEs are under the control of the Party, SOEs are not under the control of the PRC government.⁷¹

Today SOEs play a key role in all critical industries in China: steel and metals, energy exploration and production, telecommunications, banking, and air and rail travel.⁷² As the Party controls SOEs, the Party also controls all vital sectors of the economy.⁷³ The Party is able to implement its economic policies through its control of SOEs.⁷⁴ China has continuously emphasized the importance of SOEs and has continually strengthened Party control over SOEs.⁷⁵ Two initiatives stand out: China's indigenous innovation policies to help turn SOEs into "national champions" and "Made in China 2025." China's indigenous innovation policies promotes the government procurement of products containing indigenous technology over foreign made goods;⁷⁶ Made in China 2025 seeks to propel China to the top tier of the global value chain in technology innovation by 2025.⁷⁷ SOEs are both the major beneficiaries and the major catalysts of these initiatives.

One of the most troubling practices by SOEs are the subsidies that they provide to PRC companies.⁷⁸ For example, suppose that an SOE provides an input at artificially low prices to a PRC company. The low-priced input provides a financial benefit to the recipient. Or suppose that a state-owned bank provides a loan to a PRC company on favorable credit terms. In a variation of this scenario, suppose that a state-owned bank makes a loan on favorable credit terms to an SOE and then as a result of the loan the SOE is able to provide an input at artificially low prices to a private Chinese business entity. There are many other variations of these scenarios in which SOEs are able to pass through government provided financial benefits to private business entities. In her 2021 Report to Congress, the USTR described China's market-distorting policies by SOEs that affect virtually every sector of its economy:

[P]referential treatment of state enterprises, massive subsidization of domestic industries (including financial support to and through state-owned enterprises and other state entities at multiple levels of government and a banking system dominated by state-owned banks favoring state- owned enterprises and targeted industries)⁷⁹

In 2007, the United States reversed a longstanding policy of refusing to impose countervailing duties on a non-market economy on the theory that there is no market-based benchmark against

⁷¹ Eleanor Albert, Lindsay Maizland, and Beina Xu, *The Chinese Communist Party*, Council on Foreign Relations, <https://www.cfr.org/background/chinese-communist-party>.

⁷² Chow, *THE LEGAL SYSTEM OF CHINA*, *supra* note 56, at 24.

⁷³ Chow, *The Myth of China's Open Market Reforms*, *supra* note 20, at 970.

⁷⁴ *Id.*

⁷⁵ USTR 2021 Report, *supra* note 2, at 8.

⁷⁶ Daniel C.K. Chow, *China's Indigenous Innovation Policies and the World Trade Organization*, 34 *NW. J. INT'L L. & BUS.* 81, 83 (2013).

⁷⁷ Chow, *The Myth of China's Open Market Reforms*, *supra* note 19, at 969.

⁷⁸ USTR 2021 Report, *supra* note 2, at 17.

⁷⁹ USTR 2021 Report, *supra* note 2, at 17.

which to measure market distorting subsidies.⁸⁰ By 2018, the United States imposed countervailing duties on nearly 7 percent of all imports from China.⁸¹

China objected to the imposition of countervailing duties, in particular those imposed on subsidies provided by SOEs. In *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, the PRC challenged the U.S. practice in the WTO. The Appellate Body agreed with China finding that a subsidy provided by an SOE was not actionable under the WTO Agreement on Subsidies and Countervailing Duties (SCM).⁸² The Appellate Body ruled that only subsidies provided by a “governmental or public body” was a violation of the SCM.⁸³ The Appellate Body ruled that a “public body” was one that was vested with governmental authority and exercised “governmental functions.”⁸⁴ As noted above, SOEs do not fit this description and, as a result, subsidies provided by SOEs do not violate the SCM.⁸⁵ This decision infuriated the United States and contributed to the United States’ decision to cripple the WTO dispute settlement system, which is more fully discussed below.⁸⁶

To better understand the ramifications of this holding by the WTO, the next section examines the WTO approach to subsidies. This part also examines what might be the options for the United States in face of the Appellate Body definition of “public body” to exclude SOEs.

C. GATT/WTO Disciplines for Subsidies

1. A Brief Overview of Subsidies in the GATT/WTO

Subsidies were subject to discipline from the beginnings of the GATT/WTO in 1947 under GATT Articles VI and XVI.⁸⁷ During the Tokyo Round (1973-75), members of the GATT promulgated the Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade known as the “Subsidies Code,” which significantly expanded GATT disciplines on subsidies.⁸⁸ When the WTO came into existence in 1995, the WTO instituted a new comprehensive agreement on subsidies, the Agreement on Subsidies and Countervailing Duties that contains the modern rules governing subsidies that all WTO members

⁸⁰ See U.S. Department of Commerce China CVC Fact Sheet (Mar. 30, 2007). The policy against imposing countervailing duties on imports from non-market economies. NMEs was established in *Georgetown Steep Corp. v. United States*, 801 F.2d 1308 (Fed. Cir. 1986).

⁸¹ Chad Bown and Jennifer Hillman, *WTO’ing a Resolution to the China Subsidy Problem*, Peterson Institute for International Economics at 10 (Oct. 2019), <https://www.piie.com/publications/working-papers/wtoing-resolution-china-subsidy-problem>.

⁸² *United States—Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R (adopted Mar. 11, 2011).

⁸³ *Id.* at ¶¶ 134-35.

⁸⁴ *Id.*

⁸⁵ *Id.* at ¶ 322.

⁸⁶ See Part II.C *infra*.

⁸⁷ GATT, Arts. XVI and XVII.

⁸⁸ Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade, https://www.wto.org/english/docs_e/legal_e/tokyo_scm_e.pdf.

must adapt into their domestic legislation.⁸⁹ Previous GATT/WTO texts are still valid but the SCM controls in case of conflict.

The SCM defines a subsidy as (1) a financial contribution⁹⁰ from (2) a government or any public body⁹¹ (3) that confers (3) a benefit⁹² and that is (4) specific.⁹³ Each of these elements is further defined in the statute or through WTO jurisprudence.⁹⁴ Of these elements, the most controversial for the United States is the WTO interpretation of a “public body” as further discussed below.

In addition to establishing each of these elements set forth above, the complainant must demonstrate harm or “adverse effects”⁹⁵ of the subsidy except in the case of the so-called “red light” or prohibited subsidies.⁹⁶ Red light subsidies are deemed to be illegal per se; there is no need to show adverse effects because harm is presumed.⁹⁷ Two types of subsidies fall into this category. The first of these is the export subsidy, which is a subsidy contingent upon export of the product.⁹⁸ The second is an import substitution subsidy, which is a subsidy that is provided contingent upon the use of domestic goods over imports.⁹⁹ These subsidies are viewed as inherently harmful to trading partners and must be immediately withdrawn.¹⁰⁰ All other subsidies must result in harm, i.e. adverse effects, to be illegal under the SCM.¹⁰¹

2. Harm Caused by Subsidies

The use of subsidies can result in harm through three separate scenarios or through any combination of the three. Suppose that Country A and Country B are trading partners and that Country A subsidizes its domestic industries. Country B can be harmed if subsidized products from Country A (1) enter Country B’s internal market; (2) enter Country C, a third country market, which is also an export market for Country B and (3) create an a competitive advantage in Country A’s internal market over products from Country B imported into Country A.

In the first scenario, the subsidy might create a competitive advantage in the form of lower prices for Country A’s products over competing domestic products from Country B. If Country B’s consumers prefer Country A’s imports due to lower prices, Country B’s domestic

⁸⁹ World Trade Organization Agreement on Subsidies and Countervailing Measures (1994).

⁹⁰ SCM, *supra* note 89, Art. 1.1 (a)(1) (i)-(iii).

⁹¹ United States—Definitive Anti-Dumping and Countervailing Duties on Certain Products from China, *supra* note 82, at ¶¶ 134-35.

⁹² A benefit is an advantage that is not available in the marketplace. See Chow, Schoenbaum, and Dorris, *International Trade Law*, *supra* note 4, at 310.

⁹³ SCM, *supra* note 89, Art. 2.

⁹⁴ See *supra* notes 90-93.

⁹⁵ SCM, *supra* note 89, Art. 5. In the United States, the complainant is not required to prove “material injury” (i.e. adverse effects) if the respondent is from a non-WTO member. 19 U.S.C. § 1671(c).

⁹⁶ Chow, Schoenbaum, and Dorris, *INTERNATIONAL TRADE LAW*, *supra* note 4, at 511.

⁹⁷ *Id.*

⁹⁸ SCM, *supra* note 89, Art. 3.1(a).

⁹⁹ *Id.*, Art. 3.1(b).

¹⁰⁰ *Id.*, Art. 3.2.

¹⁰¹ *Id.*, Art. 5.

industries might be harmed. In some circumstances, the subsidy might allow Country A to charge a lower price for the export than the price for the same product in Country A's internal market. If this is the case, then Country A may be guilty of dumping its products in Country A in addition to providing an illegal subsidy.¹⁰² Dumping harms Country B's industries and its consumers.¹⁰³ Dumped products harm domestic industries that cannot compete with the lower price and consumers are harmed because the foreign producer might raise prices or lower the quality of its products once it achieves a niche in the market and drives out local industries.¹⁰⁴ China is a frequent target of subsidies investigations and anti-dumping actions the United States.¹⁰⁵

In the second scenario, Country B's industries might be harmed if Country B's exports cannot compete with Country A's subsidized exports in Country C. If Country C's consumers prefer Country A's products due to their lower prices, then Country B might suffer harm in one of its export markets and its export trade revenues will decrease. In the case of China, the United States argues that massive subsidies to China's domestic industries have created over-capacity in domestic industries leading China to dump excess production in third country markets and in the United States.¹⁰⁶

In the third scenario, Country B's products may be unable to compete in Country A's internal market with Country A's domestic like products that can be sold at a lower price due to the subsidy. The competitive advantage created by Country A's subsidies may become a barrier to the entry into Country A's internal market for Country B's goods. Such an import barrier might be inconsistent with market access commitments made by Country A as part of its WTO commitments. The United States claims that China's subsidized products have created import barriers preventing U.S. exports from gaining access to China's internal market.¹⁰⁷

3. GATT/WTO Remedies for Subsidies

The GATT/WTO provides two different methods to Country B to address subsidies provided by Country A: a unilateral and a multilateral route.¹⁰⁸

a. The Unilateral Route

Under the unilateral remedy, Country B is allowed to impose a countervailing duty, i.e. an additional tariff in an amount that will offset the economic benefit created by the subsidy.¹⁰⁹

¹⁰² See 19 U.S.C. § 1673(1) (dumping exists when imports sold at less than fair value); §1677b(a) (less than fair value is export price minus normal value) & § 1677b(B)(i) (i) (normal value is price sold in exporting country); see also Chow, Schoenbaum, and Dorris, *International Trade Law*, *supra* note 4, at 441.

¹⁰³ *Id.* at 443.

¹⁰⁴ *Id.*

¹⁰⁵ Congressional Research Service, *Trade Remedies: Countervailing Duties* at ii (Aug. 23, 2021), <https://crsreports.congress.gov/product/pdf/R/R46882>.

¹⁰⁶ USTR 2021 Report, *supra* note 2, at 10.

¹⁰⁷ *Id.* at 7.

¹⁰⁸ Chow, Schoenbaum, and Dorris, *INTERNATIONAL TRADE LAW*, *supra* note 4, at 509.

¹⁰⁹ 19 U.S.C. § 1671(a).

The countervailing duty is imposed on top of any existing tariffs applicable to Country A's imports so the effect of the countervailing duty is an increase in the overall tariff burden to Country A.¹¹⁰ The advantage of the unilateral remedy is that it proceeds entirely through Country B's internal legal and administrative system and can result in highly visible and expeditious relief that may be politically beneficial to Country B's government.¹¹¹ One disadvantage of the countervailing duty is that the consumer bears the burden of the increased tariff as the importer will pass on the tariff in the form of increased prices for the imports.¹¹² Increased tariffs can also contribute to inflation in Country B. In the United States, industries harmed by subsidies can bring an action that proceeds through a dual track system conducted by two U.S. entities; the International Trade Commission, which determines injury,¹¹³ and the International Trade Administration, part of the Department of Commerce, which determines if a subsidy has been provided.¹¹⁴ China is the most frequent target in anti-dumping actions in the United States.¹¹⁵

The unilateral remedy is available only if there are imports into the internal market of the complaining member. The unilateral remedy is not available to Country B in scenarios (2) and (3) above, which do not involve B's internal market.

A major limitation of the unilateral remedy is that although it authorizes the imposition of countervailing duties, it creates no legal obligation to withdraw the subsidy.¹¹⁶ The imposition of the countervailing duty will result in an increase in the price of Country A's imports and higher prices should result in a reduction of the imports into Country B due to lower demand. A reduction in trade volume in Country B will create pressure on Country A to withdraw its subsidy but Country A has no WTO obligation to do so and Country A may choose a different course of action. For example, Country A might decide instead to retaliate against Country B by imposing additional tariffs on Country B's imports, igniting a trade war. Or Country A might instead divert its exports to a third country market such as Country C. If Country C raises its import tariffs and other countries follow suit to protect their markets from being flooded by diverted subsidized imports, then a major disruption of the global supply chain might be the result.

b. The Multilateral Route

The second remedy allowed by the WTO is the multilateral route. This remedy is available in each of scenarios (1)-(3) above whereas the unilateral remedy is available only in scenario (1). A country faced with subsidized imports (scenario (1)) might choose to file a case

¹¹⁰ Id.

¹¹¹ Chow, Schoenbaum, and Dorris, *INTERNATIONAL TRADE LAW*, *supra* note 4, at 448-54.

¹¹² Id. at 447.

¹¹³ 19 U.S.C. § 1671b(a).

¹¹⁴ Id., § 1671a(a).

¹¹⁵ Chad Bown, Paola, Aksel Erbahar, Lorenzo Trimarchi, *Trade Protection Along Supply Chain: The Negative Effects of Tariffs on Downstream Sectors*, VOXEU (Feb. 3, 2021), <https://voxeu.org/article/negative-effects-tariffs-downstream-sectors>.

¹¹⁶ 19 U.S.C. § 1671(a).

in the WTO rather than using its own internal procedures, although this rarely happens in the case of the United States.

The multilateral route allows Country B to file a case in the WTO Dispute Settlement System and to have the WTO adjudicate the legality of Country A's subsidies.¹¹⁷ If Country B is successful, then the WTO will issue a ruling that Country A must withdraw the subsidy.¹¹⁸ If Country A fails to withdraw the subsidy, then Country B can ask the WTO to authorize compensation or trade retaliation.¹¹⁹ Compensation does not involve a direct payment by Country A to Country B.¹²⁰ Instead, Country A provides compensation by agreeing to additional trade concessions that benefit Country B.¹²¹ For example, Country A can lower its tariffs on certain goods from Country B. The lower tariffs should allow Country B to achieve greater market access for its goods, enjoy higher trade volumes, and to earn increased revenues.¹²² Compensation is possible, however, only possible if both of the parties agree.¹²³ If compensation is not possible, then the WTO can authorize trade retaliation or countermeasures by Country B.¹²⁴ For example, the WTO can authorize Country B to raise its tariffs on imports from Country A.¹²⁵

Compensation and retaliation are seen as steps to induce compliance and not as a final solution.¹²⁶ The ultimate goal of the WTO is to induce Country A to fully comply with the SCM and other WTO obligations by withdrawing the subsidy.¹²⁷ Only full compliance can cure the distortion to the multilateral system caused by Country A's illegal measure. Retaliation adds an additional distortion to the multilateral system, so it is viewed as temporary only.

Any WTO member is free to choose either the unilateral or multilateral remedy, but not both.¹²⁸ In the case of the U.S. industries faced with subsidized imports, the unilateral remedy is always the option of choice.

D. Bringing Subsidies Cases in the WTO

Dispute settlement in the WTO is subject to the rules set forth in the Dispute Settlement Understanding (DSU). The WTO follows a dispute settlement model that is similar to a system of civil litigation. Cases are heard in the first instance before panels, which operate like a trial court.¹²⁹ Appeals can be brought to the Appellate Body, which was functions like a high court of

¹¹⁷ SCM, *supra* note 89, Art. 7.4 -7.10.

¹¹⁸ *Id.*, Art. 7.8.

¹¹⁹ Chow, Schoenbaum, and Dorris, INTERNATIONAL TRADE LAW, *supra* note 4, at 119-20.

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.*

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ SCM, *supra* note 89, Art. 22.1

¹²⁷ *Id.*

¹²⁸ Chow, Schoenbaum, and Dorris, INTERNATIONAL TRADE LAW, *supra* note 4, at 441.

¹²⁹ *Id.* at 108.

international trade.¹³⁰ Decisions by the Appellate Body and panel decisions that are not appealed must be adopted by the Dispute Settlement Body (DSB), comprised of all WTO members, before the decision becomes legally effective.¹³¹ In adopting decisions, the DSB follows the principle of reverse consensus, i.e. that it will adopt a panel or Appellate Body report unless all DSB members vote not to adopt.¹³² Under this principle, if one member of the DSB votes to adopt, then the DSB must adopt the decision.¹³³ Following the principle of reverse consensus means that as a practical matter, all decisions submitted to the DSB are adopted.

At present, the WTO dispute settlement system is gripped in a crisis because the Appellate Body is unable to convene and cannot hear appeals.¹³⁴ Soon after the WTO was established, the United States lost several key cases before the Appellate Body leading to U.S. dissatisfaction with the performance of the Appellate Body.¹³⁵ Frustration with the Appellate body led the United States to block the reappointment of existing members or appointment of new members to the Appellate Body.¹³⁶ As a result, on December 10, 2019, the numbers of persons on the Appellate Body fell below that needed for a quorum so the Appellate Body cannot meet.¹³⁷ Panel decisions that are not appealed can be adopted by the DSB, but any Panel decision that is appealed is suspended.¹³⁸ The DSB cannot adopt a panel decision that has been appealed until the appeal is completed and the appeal cannot be completed so long as the Appellate Body cannot convene.¹³⁹ Any panel decision that is appealed becomes suspended indefinitely and has no legal effect.¹⁴⁰ This means that any party that loses before the panel can nullify the decision simply by filing an appeal. The United States recently used the appeals process to suspend a panel decision ruling that U.S. tariffs imposed on China were illegal.¹⁴¹ The U.S. appeal froze the

¹³⁰ Id. at 108-09.

¹³¹ Id. at 109.

¹³² DSU, Art. 16.4.

¹³³ Id.

¹³⁴ Chow, *Dispute Resolution under the 2020 USCTA*, *supra* note 7, at 34.

¹³⁵ Id. at 48. These cases fell into three groups: those that (1) held venerable U.S. trade statutes pre-dating the GATT/WTO to be in violation of WTO law, *see, e.g., United States – Anti-Dumping Act of 1916*, WT/DS136/AB/R ¶ 316 (Appellate Body Report adopted on Sept. 26, 2000) (rejecting U.S. anti-dumping statute in effect since 1916); (2) rejected the U.S. enforcement of federal trade law remedies such as anti-dumping laws, *see, e.g., United States—Measures Relating to Zeroing and Sunset Reviews*, ¶ 146, WTO Doc. WT/DS/322/AB/R (Appellate Body Report adopted on Jan. 23, 2007) (rejecting longstanding U.S. practice “zeroing” in antidumping investigations); and (3) ruled in favor of China on key issues such as intellectual property protection. *See, e.g., Panel Report, China—Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, ¶¶ 7.609-7.617, 7.669, WTO Doc. WT/DS362/R (adopted on Jan. 26, 2009) (rejecting U.S. claim that China’s thresholds for criminal liability failed to comply with Article 61 of TRIPS). The United States also claims that the Appellate Body exceeded its authority by repeatedly engaging in “judicial activism,” i.e. inventing rights and obligations not contained in the WTO agreements. *See* Chow, *U.S. Trade Infallibility*, *supra* note 14, at 626.

¹³⁶ Id. at 50.

¹³⁷ Id.

¹³⁸ Id.

¹³⁹ DSU, *supra* note 10, Art. 16.4.

¹⁴⁰ Chow, *Dispute Resolution under the 2020 USCTA*, *supra* note 7, at 50.

¹⁴¹ *United States – Tariff Measures on Certain Goods from China – Notification of an appeal by the*

decision in a legal limbo allowing the United States to continue its tariffs on goods from China.¹⁴² The blocking of the Appellate Body began under the Obama administration, was continued by the Trump administration, and is being maintained by the Biden administration.¹⁴³

In a following section, we discuss how the paralysis of the Appellate Body affects the suggested approach of this Article of bringing a non-violation complaint. Immediately below, we first discuss the fundamental distinction between violation and non-violation cases.

1. Nullification or Impairment

In order to bring a case, the legal standard is that the complainant must have suffered a “nullification or impairment” of a benefit accruing under the GATT/ WTO. This standard was first set forth in GATT Article XXIII and still applies today under the DSU. Article XXIII provides:

Article XXIII

Nullification or Impairment

1. If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as the result of

(a) the failure of another contracting party to carry out its obligations under this Agreement, or

(b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement, or

(c) the existence of any other situation,

the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party . . .

2. If no satisfactory adjustment is effected between the contracting parties concerned . . . the matter may be referred to the CONTRACTING PARTIES. The CONTRACTING PARTIES shall promptly investigate any matter so referred to them and shall make appropriate recommendations to the contracting parties . . . or give a ruling on the matter, as appropriate.¹⁴⁴

Situation 1(a) is known as a “violation” case because the complainant is asserting that the respondent has breached some textual provision of the WTO agreements or other binding WTO document such as a protocol of accession.¹⁴⁵ Situation 1(b) is known as a “non-violation” case

United States under Article 16 of the Understanding on Rules and Procedures Governing the Settlement of Disputes, WT/DS543/10, Oct. 27, 2020.

¹⁴² *Id.*

¹⁴³ Chow, Schoenbaum, and Dorris, *INTERNATIONAL TRADE LAW*, *supra* note 4, at 123.

¹⁴⁴ GATT, *supra* note 4, Art. XXIII.

¹⁴⁵ Chow, Schoenbaum, and Dorris, *INTERNATIONAL TRADE LAW*, *supra* note 4, at 97.

because the complainant asserts that a GATT/WTO benefit has been nullified or impaired even though the respondent has not violated an obligation created by a textual provision of the WTO.¹⁴⁶ No case has ever arisen under 1(c).¹⁴⁷ Most cases brought in the WTO dispute settlement system are violation cases, but a total of fourteen non-violation cases have also been brought.¹⁴⁸

The WTO explained the legal basis for a non-violation case as follows:

The reason is that an international trade agreement such as the WTO Agreement can never be a complete set of rules without gaps. As a result, it is possible for WTO Members to take measures that comply with the letter of the agreement, but nevertheless frustrate one of its objectives or undermine trade commitments contained in the agreement. More technically speaking, the benefit a Member legitimately expects from another Member's commitment under the WTO Agreement can be frustrated both by measures proscribed in the WTO Agreement and by measures consistent with it. If one Member frustrates another Member's benefit by taking a measure otherwise consistent with the WTO Agreement, this impairs the balance between the mutual trade commitments of the two Members. The non-violation complaint provides for a means to redress this imbalance.¹⁴⁹

*EEC – Payments and Subsidies Paid to Processors and Producers of Oilseeds*¹⁵⁰ involved a non-violation case brought by the United States against the European Economic Community (EEC). As a result of trade negotiations, the EEC agreed in 1962 on zero tariffs for imported oilseeds from the United States. Subsequently, the EEC provided industrial subsidies to EEC oilseed processors and producers. The United States challenged this measure in the GATT. In its defense, the EEC claimed that the subsidies were lawful under GATT Article III:8(b), which states that “the provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers”¹⁵¹ Article III is the National Treatment Provision prohibiting GATT/WTO members from discriminating against foreign goods and producers in favor of domestic goods and producers.¹⁵² Normally, the NT principle would require a country granting a payment to a domestic industry to either withdraw the payment or make the same payment to a foreign producer.¹⁵³ However, Article III:8(b) creates an explicit exception for domestic subsidies, recognizing their importance as instruments of domestic policy. The EEC argued that the payment of subsidies only to EEC producers did not violate the NT principle due to the exception in Article III:8(b). The United States did not challenge the legality of the

¹⁴⁶ Id.

¹⁴⁷ Id.

¹⁴⁸ World Trade Organization, Legal Basis for a Dispute, https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c4s2p2_e.htm.

¹⁴⁹ Id.

¹⁵⁰ *EEC—Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, Report of the GATT Panel, adopted on Jan. 25, 1990, GATT B.I.S.D. (37th Supp.) 86.

¹⁵¹ GATT, *supra* note 4, Art. III:8(b).

¹⁵² Id., Art. III.

¹⁵³ Id.

payment of the subsidies. Instead, the United States asserted a non-violation claim against the EEC.

The GATT panel ruled in favor of the United States.¹⁵⁴ The GATT panel stated that “the production subsidy schemes of the Community protect Community producers completely from the movement of prices for imports and hence prevent the lowering of import duties from having any impact on the competitive relationship between the domestic and imported oilseeds.”¹⁵⁵ The panel found that the United States and the EEC had negotiated the tariff concessions and that the United States had a reasonable expectation that the concessions would be maintained by the EEC.¹⁵⁶ The panel explained “The value main value of a tariff concession is that it provides an assurance of better market access through improved price competition.”¹⁵⁷ Having obtained a trade concession from the EEC, the United States had a reasonable expectation “will not be nullified or impaired by the contracting party that granted the concession by the introduction or increase of the domestic subsidy.”¹⁵⁸

The GATT panel also emphasized a finding of a nullification and impairment did not depend on the United States’ proof that trade volumes for its oilseeds had actually decreased in the EEC.¹⁵⁹ Instead the GATT panel emphasized that the provisions of the GATT/WTO serve “to protect expectations of the contracting parties as to the competitive relationship between their products and those of other contracting parties.”¹⁶⁰ The panel reaffirmed its past approach of that “findings of nullification or impairment were based on a finding that the products for which a tariff concession had been granted were subjected to an adverse change in competitive conditions.”¹⁶¹ Note that in the *EEC Oilseeds* case, the GATT panel did not find that the production subsidies were illegal under the GATT. As the panel did not find that the subsidies were illegal, the EEC had no obligation to withdraw them. Rather, the panel found that the subsidies, even if lawful, resulted in a nullification or impairment of benefit that had accrued to the United States.

2. Bringing a WTO Violation Case against China

The WTO’s position on SOEs has limited U.S. options in using the WTO dispute settlement process. A dispute in which the United States asserts that China’s SOEs are providing subsidies in breach of the SCM is a violation case. If the United States were to use the multilateral route and challenge financial contributions provided by China’s SOEs to Chinese business entities, the United States is likely to lose the case in light of the WTO’s interpretation that a “public body” must exercise “governmental functions.” Similarly, if the United States uses the unilateral route and imposes countervailing duties on financial contributions by SOEs, China

¹⁵⁴ *EEC – Payments and Subsidies*, *supra* note 150, at ¶ 152.

¹⁵⁵ *Id.* at ¶ 147.

¹⁵⁶ *Id.* at ¶ 148.

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

¹⁵⁹ *Id.* at ¶ 150.

¹⁶⁰ *Id.*

¹⁶¹ *Id.*

will be able to challenge the U.S. duties in the WTO on the ground that these payments are not subsidies and will likely prevail. Note that a unilateral action is necessarily a violation case.

The United States could attempt to argue that a violation of the SCM exists because the PRC government is using SOEs as a conduit to pass through subsidies to Chinese business entities and that the government is actually responsible for the payment. However, this line of argument encounters a high bar. Article 1.1(a)(1)(iv) of the SCM provides that there is a financial contribution by a government in any situation where:

[A] government makes payments to a funding mechanism, or *entrusts or directs* a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differences from practices normally followed by a government . . . (emphasis added)¹⁶²

In *United States – Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMs) from Korea*, the Appellate Body explained the terms “entrusts or directs” as follows:

The term “entrusts” connotes the action of giving responsibility to someone for a task or an object. . . . [T]he government gives responsibility to a private body to “carry out” [a government function] As for the term “directs”, we note that some of the definitions – such as “give authoritative instructions to” and “order [a person] to do” – suggests that the person or entity that “directs” has authority over the person or entity or entity that is directed.¹⁶³

The relationship between SOEs and the PRC government do not indicate the PRC government entrusts or directs SOEs to make financial contributions. SOEs are business entities that do not report to the PRC government and PRC government entities cannot give authoritative instructions to SOE to make a financial payment. SOEs are business entities that by law have the autonomy to make their own business decisions. The WTO’s interpretation of “public body” and the meaning of “entrusts or directs” appears to have closed the door on the ability to a violation case to challenge subsidies provided by China’s SOEs.

3. Advantages of a Non-Violation Case

The United States can, however, bring a non-violation case. The basic outline of such a claim is as follows: As *EEC Oilseeds* indicates, in a non-violation case, the United States does not need to challenge the legality of the payments made by SOEs; the United States argument is that the subsidies by SOEs have changed the competitive conditions of the relationship between U.S. imports and domestic products and have nullified and impairment the market access commitments China made as a condition of its admission to the WTO and as a result of trade negotiations with the United States. As part of its admissions package, China negotiated a tariff

¹⁶² SCM, *supra* note 89, Art. 1.1(a)(1)(iv).

¹⁶³ *United States – Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMs) from Korea*, WT/DS296/AB/R (Report of the Appellate Body adopted on July 20, 2003), at ¶¶ 110-111.

schedule with all other WTO members. China's tariff schedule, made an annex to the GATT, sets a ceiling on tariffs that was designed to provide market access to imports from the United States and other countries. The United States has a reasonable expectation that China will maintain its market access commitments and will not undermine these obligations through other measures. Subsidies provided through China's SOEs, even if lawful, upset the competitive conditions between U.S. imports and Chinese domestic products. SOEs subsidies nullify and impair the benefits to the United States of China's access commitments in its tariff schedule.

A non-violation case against China on the issue of SOE subsidies has a number of advantages over a violation case. If the complainant brings and wins a violation case against China's SOE subsidies, then the WTO will issue a ruling that these measures are illegal under the SCM.¹⁶⁴ China would then have an obligation to withdraw the measures or be subject to U.S. demands for compensation or retaliation. Given China's commitment to the role of SOEs in its economy, it is not likely that China will withdraw or change these policies.¹⁶⁵ China may choose instead to pay compensation or to suffer trade retaliation indefinitely. Even if China were to choose this option rather than withdrawing or revising its policies, China would suffer the political embarrassment of being in violation of the WTO agreements when China is currently promoting its image as a leading GATT/WTO country that is in favor of increasing globalization. China's standing and credibility in the WTO would be diminished if China refused to withdraw a measure found by the WTO to be illegal.

By contrast, a U.S. victory in a non-violation case does not require a finding that a measure was illegal or that China withdraw the measure. There is also no obligation to withdraw the measure. Article 26:1(b) of the DSU provides:

[W]here a measure has been found to nullify or impair benefits under, or impede the attainment of objectives, of the relevant covered agreement without violation thereof, there is no obligation to withdraw the measure. However, in such cases, the panel or the Appellate Body shall recommend that the Member concerned make a mutually satisfactory adjustment[.]¹⁶⁶

A "mutually satisfactory adjustment" can take a number of forms, all of which can allow China to leave a contested measure in place. For example, China might make additional trade concessions in the form of lower tariffs for U.S. imports to restore the competitive relationship between U.S. imports and domestic products. Or China might provide a tariff-rate quota in which a certain quantity of imports from the United States enter China's internal market duty free (the in-quota amount) and then imports above that quantity are subject to normal tariffs (the out-of-quota amount). Another possibility is that China could commit to buying U.S. goods and services

¹⁶⁴ SCM, *supra* note 89, Art. 7.8.

¹⁶⁵ In 2013, at the conclusion of the Third Plenum of the CPC, the Party reaffirmed its commitment to SOEs by declaring it would "incessantly strengthen [the] vitality" of SOEs. Bob Davis & Brian Spegele, *State Companies Emerge as Winners Following Top China Meeting: Enterprises Fended Off Calls to Curb Their Influence*, WALL. ST. J. (Nov. 13, 2013), <https://www.wsj.com/articles/state-companies-emerge-as-winners-following-top-china-meeting-1384352718>.

¹⁶⁶ DSU, *supra* note 10, Art. 26:1(b).

of an agreed amount as compensation to the United States. These are simply a few examples of bargains that the United States and China can reach to resolve the subsidies issue. A non-violation case offers flexibility in remedies not possible under a violation case. Most importantly, China would not be obligated to change its domestic policies that favor SOEs to which China appears to be fully committed.

Another advantage of a non-violation case is that the United States could achieve significant political objectives in the WTO from bringing such a case even if the United States loses. A famous example of how a loss in litigation led to a watershed political victory occurred in late 1961 when Uruguay filed a complaint against the bulk of the developed-country membership of the GATT.¹⁶⁷ At the time, still early in the GATT's history, most countries in the GATT were developing countries and suffered shabby treatment from developed countries.¹⁶⁸ Uruguay lost its case but the case served to call attention to the poor treatment of developing countries in the GATT and was one of the catalysts that led the GATT to eventually adopt the Enabling Clause, which recognized permanent "differential and more favorable treatment" for developing countries, setting the stage for the many preferences that developing countries enjoy today in the GATT/WTO.¹⁶⁹

Assume that the United States, the European Union, and Japan, which have formed a trade alliance to challenge China's non-market policies, join together in a non-violation case against China challenging its SOE subsidies.¹⁷⁰ Arrayed on one side are the three largest free markets in the world, the United States, the EU, and Japan, against the second largest economy in the world, China. All four countries are also leading members of the GATT/WTO. Such a high profile case is sure to gain the highest level of interest and attention of the entire WTO membership. The case will draw to the attention of the WTO membership the claim that China's state-led economy is in conflict with the basic free market principles of the WTO. That a state-led economy is at odds with the WTO is uncontested. Such a case, even if unsuccessful, might lead the GATT/WTO to examine how to reconcile China's massive state-led economy with the basic framework of the WTO. The case could be a catalyst to formal change in the WTO, new commitments from China, or the parties might bargain with China to receive a satisfactory solution. The lawsuit could give the United States, EU, and Japan the leverage needed to make positive changes in their economic relationships with China. The United States might benefit from a non-violation case, even if unsuccessful.

An additional advantage of having the EU join the lawsuit is that the EU is a leading member of the Multiparty Interim Appeal Arbitration Arrangement, which is a WTO agreement

¹⁶⁷ Chow, Schoenbaum, and Dorris, *INTERNATIONAL TRADE LAW*, *supra* note 4, at 718-19.

¹⁶⁸ *Id.*

¹⁶⁹ See GATT Decision of 28 November 1979, L/4903, Differential and More Favourable Treatment Reciprocity and Fuller Participation of Developing Countries, https://www.wto.org/english/docs_e/legal_e/enabling1979_e.htm (official name of Enabling Clause).

¹⁷⁰ Jenny Leonard, Alberto Nardelli, and Bryce Baschuk, *The United States, the EU, and Japan have formed a trade alliance to challenge China's trade distorting non-market policies*, BLOOMBERG (Nov. 17, 2021), <https://www.bloomberg.com/news/articles/2021-11-17/u-s-eu-japan-to-renew-alliance-against-china-trade-practices>.

designed to allow appeals from panel decisions while the crisis created by the paralysis of the Appellate Body is being resolved.¹⁷¹ As a result of the EU's leading role, the MPIA was created as a voluntary agreement concluded under the auspices of the WTO. The MPIA allows its members to appeal panel cases to an interim MPIA Appellate Body constituted under Article 25 of the DSU.¹⁷² The MPIA Appellate Body functions under the DSU rules applicable to the permanent Appellate Body and the panelists are drawn from an agreed upon list of qualified persons or a pool similar that used for the permanent Appellate Body.¹⁷³ Decisions by the MPIA Appellate Body are not open for adoption by the DSB, but as a member of the MPIA, China has a legal obligation to abide by a final MPIA Appellate Body decision.¹⁷⁴

While the United States and Japan are not members of the MPIA, both the EU and China are members.¹⁷⁵ Under the MPIA, China has agreed to forgo the appeal of MPIA cases under the WTO appeals procedure set forth in the DSU Articles 16.4 and 17.¹⁷⁶ Instead China must allow cases involving the EU to be appealed to the MPIA Interim Appellate Body.¹⁷⁷ Although the United States, a non-member of the MPIA, is a party to the non-violation case, the MPIA text is clear that any dispute that involves at least one party from the MPIA on both sides of the dispute, i.e. the EU and China, brings the case within the jurisdiction of the MPIA.¹⁷⁸ So long as the EU is a party to the dispute, the MPIA applies; if China loses the dispute before the WTO panel, China is unable to suspend the panel decision by filing an appeal under the DSU. If China attempts to “sever” the case as it applies to the United States and appeal only that part of the case under the DSU in order to suspend the case involving the United States, China will find that it is precluded from doing so under the DSU.¹⁷⁹ Unlike the practice in the U.S. federal court system, nothing in the DSU or the WTO allows a losing party to file an appeal concerning only one of the winning parties. The language of the DSU indicates that there is a single report subject to

¹⁷¹ MPIA, *supra* note 42.

¹⁷² *Id.*

¹⁷³ *Id.*, Art. 4, annex 2.

¹⁷⁴ *Id.*, Annex I, Art. 15. One of the weaknesses of the MPIA is that because its decisions are not adopted by the DSB, MPIA decisions never become part of WTO jurisprudence

¹⁷⁵ Geneva Trade Platform, Multi-Party Interim Appeal Arbitration Arrangement (MPIA), https://wtoplurilaterals.info/plural_initiative/the-mpia/

¹⁷⁶ The MPIA provides:

1. The participating Members indicate their intention to resort to arbitration under Article 25 of the DSU as an interim appeal arbitration procedure (hereafter the "appeal arbitration procedure"), as long as the Appellate Body is not able to hear appeals of panel reports in disputes among them due to an insufficient number of Appellate Body members.

2. In such circumstances, the participating Members will not pursue appeals under Articles 16.4 and 17 of the DSU.

¹⁷⁷ MPIA, *supra* note 42, Art. 1.

¹⁷⁸ MPIA, *supra* note 42, Art. 9 (“The MPIA applies to any future dispute between any two or more participating Members[.]”).

¹⁷⁹ DSU, *supra* note 10, Art. 16.4.

appeal.¹⁸⁰ The single report is subject to the MPIA appeal process because China and the EU are both MPIA members.¹⁸¹

Having the EU join as a party to the non-violation case might result in the following tactical legal advantages to the United States: if the United States loses the case, the United States, as a non-member of the MPIA, can appeal the case to the decommissioned Appellate Body and suspend the decision in a legal limbo. If the United States wins the case, China might be locked into using the MPIA to appeal the case and may be precluded from suspending the case by filing an appeal to the decommissioned Appellate Body.

So far we have examined the legal basis and rationale for the United States to bring a non-violation case against China. Although the United States may have a valid legal basis to bring a non-violation case, that possibility is not enough of a reason to bring the case. In addition, there must also be an economic basis for bringing a non-violation case. The economic case will explain why the power-based approach of the Trump administration undermines the successful economic logic of the GATT/WTO that has reduced world tariffs to historically low levels. A non-violation case will return the United States to a rules-based approach and will create the economic incentives to bring a salutary outcome to the prisoners' dilemma of U.S.-China trade. In the next part of this Article, we explain why a non-violation case will create the economic conditions for the parties to bargain to an efficient outcome and resolve many of the hurdles that currently prevent a resolution of the problems of U.S.-China trade. Together with the legal basis discussed so far, the economic case for the non-violation complaint helps provide a clear strategy for the United States from this point forward in dealing with China trade tensions.

III.

“POWER-BASED” BARGAINING AND TRADE NEGOTIATIONS

In evaluating U.S. trade relations with China, some observers have interpreted the recent trade war between the two countries as the former switching from a “rules-based” to a “power-based” approach to trade negotiations, an approach that has the potential to undermine the multilateral trading system established under the GATT and its successor the WTO.¹⁸² This change in US trade policy emphasis has consisted of targeting higher “bargaining tariffs” at a country with which it has consistently run a bilateral trade deficit, as well as being driven by well-documented concerns the United States has about its trade relations with China, including the latter’s higher average bound tariffs, manipulation of its exchange rate, and its violation of

¹⁸⁰ Id., Art. 16.4 (“Within 60 days after the date of circulation of a panel report to the Members, the report shall be adopted at a DSB meeting unless a party to the dispute formally notifies the DSB of its decision to appeal or the DSB decides by consensus not to adopt the report.”).

¹⁸¹ MPIA, *supra* note 42, Art. 9.

¹⁸² Aaditya Mattoo, and Robert W. Staiger, *Trade Wars: What Do They Mean? Why Are They Happening Now? What Are the Costs?*, 35 ECON. POL. 561, 573-576 (2020); see also Ian M. Sheldon, *The United States’ Power-Based Bargaining and the WTO: Has Anything Really Been Gained?*, APPLIED ECON. PERSPECTIVES AND POLICY 1, 4 (forthcoming 2022).

WTO rules.¹⁸³ As previously noted, a key component of this “power-based” approach has also been the disabling of the dispute settlement system of the WTO through paralyzing its Appellate Body.¹⁸⁴

Not surprisingly, given the height and breadth of the tariffs applied by the United States against China in 2018, analysis of the short-run economic impacts has already been published.^{185,186} Without discussing the technical details, one study quantifies the impact of the trade war on the United States for 2018 as follows: first, U.S. consumers of imported goods in aggregate lost \$51 billion due to higher prices; second, U.S. exporters saw an increase in their income of \$9.4 billion; and third, U.S. tariff revenue totaled \$34.3 billion.¹⁸⁷ Therefore, the net effect of the trade war was an aggregate loss of U.S. real income of \$7.3 billion, which can be thought of as an approximation of the deadweight loss from tariffs. This compares to a second study which estimated a net real income loss of \$8.2 billion.¹⁸⁸ Currently, there is an ongoing debate in the Biden administration over cutting these tariffs to reduce the current U.S. rate of inflation.¹⁸⁹ Available estimates suggest that eliminating the tariffs against China would result in a 1.3 percentage point long-term reduction in the consumer price index (CPI), increasing to a 2.0 percentage point reduction if other trade barriers were reduced.¹⁹⁰

In terms of U.S. exports, retaliatory tariffs disproportionately affected agricultural products compared to other sectors, and the tariff increases were also steeper. Empirical analysis indicates the U.S. agricultural sector suffered annualized trade losses of \$13.5 to \$18.7 billion, China accounting for the majority and severity of the retaliation, damage to soybean exports being estimated at \$10.7 billion.¹⁹¹ Importantly, with China being the world’s largest soybean importer, it was able to negatively affect U.S. international terms-of-trade, the average U.S. soybean export price falling significantly when tariffs were initially implemented by China, putting downward pressure on U.S. farm incomes,¹⁹² with a significant amount of trade also

¹⁸³ See Wayne M. Morrison, *China-U.S. Trade Issues* at 29-54, Congressional Research Service (2018).

¹⁸⁴ See Joost Pauwelyn, *WTO Dispute Settlement Post 2019: What to Expect?*, 22 J. INT’L ECON. LAW 297, 297-300 (2019).

¹⁸⁵ See Mary Amity, Stephen J. Redding, and David E. Weinstein, *The Impact of the 2018 Tariffs on Prices and Welfare*, 33 J. OF ECON. PERSPECTIVES 187, 187-89 (2019).

¹⁸⁶ See Pablo D. Fajgelbaum, Pinelopi L. Goldberg, Patrick J. Kennedy, and Amit K. Khandelwal, *The Return to Protectionism*, 135 QUARTERLY J. OF ECON. 1, 2-6 (2020).

¹⁸⁷ See *Id.*, 42-45.

¹⁸⁸ See Amity *et al.*, *supra* note 185, 199-201.

¹⁸⁹ See Megan Hogan and Yilin Wang, *To Fight Inflation, Cutting Tariffs on China is only the Start*, Realtime Economic Issues Watch, Peterson Institute for International Economics (June 3, 2022), <https://www.piie.com/blogs/realtime-economic-issues-watch/fight-inflation-cutting-tariffs-china-only-start>.

¹⁹⁰ See Gary C. Hufbauer, Megan Hogan, and Yilin Wang, *For Inflation Relief, the United States Should Look to Trade Liberalization*, Policy Brief 22-4, Peterson Institute for International Economics (Mar. 5, 2022).

¹⁹¹ See Jason H. Grant, Shawn Arita, Charlotte Emlinger, Robert Johansson, and Chaoping Xie, *Agricultural Exports and Retaliatory Trade Actions: An Empirical Assessment of the 2018/2019 Trade Conflict*, 43 APPLIED ECON. PERSPECTIVES AND POL. 619, 626-29 (2021).

¹⁹² See Michael K. Adjemian, Shawn Arita, Vince Breneman, Robert Johansson, and Ryan Williams, *Tariff Retaliation Weakened the U.S. Soybean Basis*, 34 CHOICES 1, 1 (2019).

being diverted to other exporting countries such as Brazil.¹⁹³ This resulted in compensatory payments to U.S. farmers through the Market Facilitation Program (MFP), pushing the United States close to violating its WTO commitments on farm subsidies in 2019 and 2020.¹⁹⁴

The obvious conclusion to draw here is that the U.S.-China trade war came at a cost to U.S. consumers, taxpayers, and exporters. For all intents and purposes, the United States and China have chosen to suspend their GATT/WTO obligations, which has significant long-run implications for the “rules-based” multilateral trading system.¹⁹⁵ First, any initial advantage the United States might have gained by applying bargaining tariffs has likely been lost as China and other countries such as the EU have retaliated. This has the potential to undermine the cooperation necessary for multilateral as opposed to bilateral trade negotiations, with implications for enforcement.¹⁹⁶ Second, if the multilateral system is undermined when the United States is the dominant economic power, it may prove harder for China to make credible commitments to a “rules-based” mechanism when it eventually becomes the dominant economic power.¹⁹⁷

However, the analysis does not end here given USCTA was signed on January 15, 2020.¹⁹⁸ Even though neither country agreed to return tariffs to their pre-2018 bound levels, China did commit to a voluntary import expansion (VIE) over 2017 baseline levels, implying a combined \$200 billion worth of additional imports of U.S. products (agricultural, manufactured, and energy) and services for the two-year period January 1, 2020, through December 31, 2021.¹⁹⁹ China’s imports from the United States reached 59 percent of their commitment for 2020, and by the end of December 2021, they had reached only 57 percent of their two-year commitment.²⁰⁰ In the case of the agricultural and manufacturing sectors, China reached 83 and 59 percent respectively of their two-year commitments.

Despite China not meeting their import commitments, it is important to acknowledge efforts were made by both countries to resolve their dispute through the bilateral agreement. Specifically, while USCTA neither addressed nor proscribed its domestic industrial policies, the agreement essentially had China offering explicit compensation to the United States in the form of increased market access. In other words, even though the agreement lies outside the bounds

¹⁹³ See Colin A. Carter and Sandro Steinbach, *The Impact of Retaliatory Tariffs on Agricultural and Food Trade*, NBER Working Paper 27147, 12, 12-13 (2020).

¹⁹⁴ See Joseph W. Glauber, *Is it Time for the United States to Again Show Leadership at the WTO?*, American Enterprise Institute, Center for Strategic and International Studies (Sept. 16, 2020), <https://www.csis.org/analysis/it-time-united-states-again-show-leadership-wto>.

¹⁹⁵ See Mattoo and Staiger, *supra* note 182, at 570-73.

¹⁹⁶ See Giovanni Maggi, *The Role of Multilateral Institutions in International Trade Cooperation*, 89 AM. ECON. REV. 209, 209-10 (1999).

¹⁹⁷ See Mattoo and Staiger, *supra* note 182, at 573-76.

¹⁹⁸ See USCTA, *supra* note 16.

¹⁹⁹ See Chad P. Bown, *US-China Phase One Tracker: China’s Purchases of US Goods*, Peterson Institute of International Economics Charts (July 19, 2022), <https://www.piie.com/research/piie-charts/us-china-phase-one-tracker-chinas-purchases-us-goods>.

²⁰⁰ See Chad P. Bown, *China Bought None of the Extra \$200 billion of US Exports in Trump’s Trade Deal*, Realtime Economic Issue Watch at 1, Peterson Institute for International Economics (Feb. 8, 2022), <https://www.piie.com/sites/default/files/documents/bown-china-us-exports-trade-deal-2022-02.pdf>.

of the WTO, it appears to incorporate a dimension of GATT/WTO rules by allowing for breach by China and payment of damages to the United States, i.e., a liability contract.²⁰¹ This suggests the dispute between the two countries should be revisited in the context of a non-violation complaint by the United States, as allowed under GATT Article XXIII:1(b).

IV. THE ECONOMIC LOGIC OF GATT/WTO

A. Resolution to a Prisoner's Dilemma

Understanding non-violation complaints from a legal-economic perspective requires analysis of the economic rationale for trade agreements. The logic of the GATT/WTO has been explained by trade economists in terms of the resolution to a terms-of-trade prisoner's dilemma.²⁰² Assume a world where two countries produce and consume two products, x and y , one country having a comparative advantage in producing and exporting x , while the other has a comparative advantage in producing and exporting y , both being large enough to influence their terms-of-trade, i.e., the price they pay on the world market for imports relative to the price they receive on the world market for their exports. For example, if the country importing x imposes an import tariff, the world price of x will fall relative to the price of good y , the other country thereby incurring an international terms-of-trade loss.²⁰³ Of course if the other country retaliates by imposing an import tariff on good y , both countries incur losses.²⁰⁴

With appropriate assumptions, the economic welfare of each country can be defined as a function of tariffs, the terms-of-trade gain to each outweighing any domestic deadweight loss due to imposition of a tariff.²⁰⁵ In the absence of a trade agreement, the equilibrium of the tariff game will be the solution to a prisoners' dilemma, i.e., it will be optimal for each country to set a high tariff whatever the tariff choice of the other country, neither country being able to change their tariff strategy and be better off, i.e., a Nash equilibrium. The net result is each country loses market access to the other country's market, the reduction in the volume of international trade being economically inefficient.

The latter outcome suggests it is Pareto-improving for both countries to agree to reduce their tariffs, and in the absence of a binding bilateral agreement between them, the GATT/WTO has essentially neutralized the terms-of-trade incentive for countries to raise tariffs.²⁰⁶ In other words, if terms-of-trade effects have been removed from any country's economic welfare function, it will set tariffs to satisfy domestic political objectives alone. These tariffs would be either zero if a country seeks to maximize its national income through free trade, or they would

²⁰¹ See Warren F. Schwartz and A.O Sykes, *The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization*, 31 J. LEGAL STUDIES S179, S188-S189 (2002).

²⁰² See Kyle Bagwell, and Robert W. Staiger, *An Economic Theory of GATT*, 89 AM. ECON. REV. 215, 216-17 (1999).

²⁰³ See James R. Markusen, James R. Melvin, William H. Kaempfer, and Keith A. Maskus, *INTERNATIONAL TRADE: THEORY AND EVIDENCE* 254-56 (1995).

²⁰⁴ See Bagwell and Staiger, *supra* note 202, at 221-23.

²⁰⁵ See Benjamin Zissimos, *The GATT and Gradualism*, 71 J. OF INT'L ECON. 410, 414-15 (2007).

²⁰⁶ See Bagwell and Staiger, *supra* note 202, at 217.

be positive to satisfy domestic political constraints, but importantly, they are lower than those at the Nash equilibrium.²⁰⁷ Therefore, if countries enter into a trade agreement, they seek mutual reductions in tariffs generating an increase in domestic and global economic welfare. Over the 75 years of its existence, the GATT/WTO has witnessed eight rounds of trade negotiations, resulting in average industrial tariffs being reduced to less than 4 percent.²⁰⁸

The lower tariff equilibrium under GATT/WTO has also been supported by a credible enforcement mechanism embodied in the dispute settlement system. Standard game theory suggests countries would have an incentive to deviate from a low-tariff equilibrium. In a standard repeated game, the punishment for not adhering to a trade agreement is reversion to the Nash equilibrium of high tariffs, i.e., a trigger strategy.²⁰⁹ In practice, the rules of GATT/WTO seek to maintain the balance of tariff concessions and avoid the use of punitive, and therefore economically destructive actions.²¹⁰

If one country were to raise its tariff(s), this would imply a loss of previously negotiated market access for the other country. Assuming this action is not “abusive”, under GATT/WTO rules, specifically GATT Article XXIII, subject to a ruling by the dispute settlement mechanism, the other country can withdraw an equivalent amount of market access.²¹¹ However, if a country deviates in an “abusive” manner, there is reversion to the trigger strategy, i.e., under GATT Article XXIII, there can be an indefinite suspension of GATT/WTO obligations, both countries setting Nash equilibrium tariffs.²¹² In other words, the objective of GATT/WTO rules is to ensure agreed retaliation by one country against the unilateral action of another is proportionate, thereby minimizing the chances of a trade war.

The intuition for this result is straightforward: first, if the deviation from the bound tariff by one country is less than the Nash equilibrium tariff, it is not considered “abusive”, the other country withdrawing an equivalent amount of market access in all future periods through setting a similar retaliatory tariff; second, if the deviation from the agreed tariff is greater than or equal to the Nash equilibrium tariff, it is considered “abusive”, the other country setting the higher retaliatory tariff in all future periods.²¹³ Importantly, where the deviation is not “abusive”, withdrawing an equivalent amount of market access is credible, i.e., the punishing country knows if it instead chooses the more than proportionate tariff, this will result in a suspension of GATT/WTO obligations with indefinite imposition of Nash equilibrium tariffs by both countries.

²⁰⁷ See *Id.* at 224.

²⁰⁸ See John H. Jackson, *THE WORLD TRADING SYSTEM* 74 (1989).

²⁰⁹ See Avinash Dixit, *Strategic Aspects of Trade Policy* in *ADVANCES IN ECONOMIC THEORY: FIFTH WORLD CONGRESS* 329-59, 329-35 (Truman F. Bewley, ed. 1987).

²¹⁰ See Robert W. Staiger, *International Rules and Institutions for Trade Policy* in *HANDBOOK OF INTERNATIONAL ECONOMICS VOLUME 3* 1495, 1519-28 (Gene Grossman and Kenneth Rogoff, eds. 1995).

²¹¹ While GATT/WTO rules contain no formal definition of an “abusive” deviation, a reasonable interpretation would be a “sufficiently deep” breakage of tariff commitments honored for some time. See Zissimos *supra* note 205, at 412.

²¹² See Jackson, *supra* note 208, at 94.

²¹³ See Zissimos, *supra* note 205, at 417.

While there is empirical support for both the idea of importing countries having market power, and the terms-of-trade theory of trade agreements,²¹⁴ the theory as outlined has been criticized on the grounds that trade practitioners never actually mention the concept of terms-of-trade in trade negotiations.²¹⁵ However, this ignores the relationship between import demand and import prices.²¹⁶ Suppose one country lowers its import tariff, which shifts out its import demand curve, resulting in an increase in the world price of the imported good (a worsening of its terms-of-trade). Necessarily, this has an import volume effect, i.e., the other country gets increased market access as their terms-of-trade improve. In other words, the problem with the non-cooperative tariff equilibrium can be recast as one of insufficient market access.²¹⁷ Therefore, a link can be made between the terms-of-trade theory, changes in relative prices, and the focus of trade negotiators on market access. Importantly, countries participating in reciprocal trade negotiations have enjoyed a significant increase in trade, and bilateral trade has been greater when both countries engage in tariff reduction.²¹⁸

B. Return to the Nash Equilibrium?

The recent history of tariffs imposed by the United States and China on each other's imports is summarized as follows: prior to 2018, U.S.-China trade-weighted tariff rates toward each other averaged 3.1 and 8 percent respectively.²¹⁹ By the end of 2018, trade-weighted average US tariffs on 46.9 percent of its imports from China had been raised to 12 percent, matched by an increase in trade-weighted average Chinese tariffs to 16 percent on 56.3 percent of its imports from the United States. When the USCTA was signed in early-2020, trade-weighted average U.S. tariffs on 58.3 percent of its imports from China had risen to 19.3 percent (26.7 percent including anti-dumping duties), while trade-weighted average Chinese tariffs on 66.4 percent of its imports from the United States had risen to 20.7 percent (21.2 percent including anti-dumping duties).²²⁰ Therefore, over this two-year period, trade-weighted average U.S. tariffs against China (including anti-dumping duties) more than tripled relative to their pre-

²¹⁴ See Christian Broda, Nuno Limao, and David E. Weinstein, *Optimal Tariffs and Market Power*, 98 AM. ECON. REV. 2032, 2032-34 (2008); see also Kyle Bagwell and Robert W. Staiger, *What Do Trade Negotiators Negotiate About? Empirical Evidence from the World Trade Organization?*, 101 AM. ECON. REV. 1238, 1238-41 (2011).

²¹⁵ See Donald H. Regan, *Explaining Trade Agreements: The Standard Practitioners' Story and the Standard Model*, 14 WORLD TRADE REV. 391, 391-95 (2015).

²¹⁶ See Robert W. Staiger, *A World Trading System for the Twenty-First Century* 51, 51-57 (Oct. 2021), https://cpb-us-e1.wpmucdn.com/sites.dartmouth.edu/dist/b/2093/files/2021/10/Ohlin_Book_RWS_Final_Revision_10142021.pdf.

²¹⁷ See *Id.* at 51-57.

²¹⁸ See Arvind Subramanian, and Shang-Jin Wei, *The WTO Promotes Trade, Strongly but Evenly*, 72 J. INT'L ECON. 151, 151-53 (2007).

²¹⁹ See Chad P. Bown, *The US-China Trade War and Phase One Agreement*, 43 J. POL. MODELING 4 805, 812-18 (2021).

²²⁰ See *Id.* at 814.

2018 level of 8.4 percent, approaching the trade-weighted average tariff level of 28.1 percent imposed under the Smoot-Hawley tariff act of 1930.²²¹

This sequence of moves on tariffs bears out the previous discussion. First, the 2018 implementation of tariffs under Section 301 of the U.S. 1974 Trade Act does not satisfy the criterion of being “non-abusive”, there being no attempt by the United States to seek renegotiation of its existing tariff commitments to China under GATT/WTO rules. Second, a WTO panel ruled in China’s favor on September 15, 2020 that the tariffs were “...*prima facie* inconsistent...” with both Articles I.1 and II of the GATT 1994, i.e., the tariffs are both discriminatory and in excess of the rates “...to which the United States bound itself in its Schedule of Concessions...” (WTO, November 26, 2020).²²² Third, even though China filed a complaint with the WTO in 2018, the fact it retaliated immediately with substantial tariffs of its own suggests it was willing to implement a trigger-type strategy well before the subsequent Panel ruling in 2020. Fourth, the extent of escalation of tariffs by both countries through 2019 indicates both countries had moved towards applying trigger strategies, pushing their bilateral relationship to a Nash equilibrium.

V.

GATT/WTO: ADDRESSING DOMESTIC POLICIES

A. Shallow-Integration

As noted earlier, many of the concerns relating to China go well beyond tariffs, instead focusing on their use of domestic policies, yet the terms-of-trade theory just described relates entirely to the use of tariffs. Of course, the GATT/WTO is a multilateral trade agreement characterized by shallow-integration, i.e., countries possess multiple policy instruments, but cutting and binding tariffs has been the predominant focus of negotiations.²²³ However, shallowness should be set in the context of the GATT/WTO being an incomplete contract. Specifically, there are two key challenges when negotiating a trade agreement: first, the contract must place constraints on the ability of governments to act opportunistically in utilizing a range of policy instruments beyond just tariffs; and second there is considerable uncertainty about contingencies arising over the lifetime of the agreement.²²⁴ In an ideal world, the contract should be state-contingent, but in reality, contracting costs are likely to be substantial, the latter increasing in both the number of policies included and the contingencies specified.²²⁵

²²¹See Chad P. Bown, and Douglas A. Irwin, *What Might a Trump Withdrawal from the World Trade Organization Mean for US Tariffs?*, Policy Brief 1, 2-8, 18-23, Peterson Institute for International Economics (2018).

²²² See *United States-Tariff Measures on Certain Goods from China*, WT/DSS543/R, Report of the Panel adopted on November 26, 2020, https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds543_e.htm.

²²³ See Staiger, *supra* note 216, at 1.

²²⁴ See Henrik Horn, Giovanni Maggi, and Robert W. Staiger, *Trade Agreements as Endogenously Incomplete Contracts*, 100 AM. ECON. REV. 394, 394-97 (2010).

²²⁵ See *Id.* At 395; see also Schwartz and Sykes, *supra* note 201, at S181.

Returning to the model outlined earlier, suppose there are two market failures associated with industry x in the importing country: a positive production externality and a negative consumption externality. Assuming only a production subsidy and tariff are available, the optimal policy consists of an import tariff, which drives up the consumer price to reflect the negative externality, and a production subsidy which drives up the producer price to account for the positive externality.²²⁶ If there is no trade agreement, the importing country continues setting the optimal production subsidy but also sets the tariff optimally to exploit their market power. Therefore, the benefit of any agreement relates to preventing a country manipulating its terms-of-trade. In fact, it is necessary that an agreement should primarily focus on tariffs, as opposed to domestic policies such as a production subsidy. The intuition for this is as follows: in agreeing to lower its tariff, the country importing x is constraining its first-best policy instrument targeted at reducing imports and manipulating its terms-of-trade, but even if the use of domestic policies is unrestricted, the level of imports is unlikely to be restored to the pre-agreement level due to their being an imperfect substitute for tariffs.²²⁷

The preceding analysis explains why the GATT/WTO approach has been characterized as one of shallow-integration – binding tariffs to address manipulation of the terms-of-trade.²²⁸ An important question remains though: how much discretion should countries such as China be allowed over their domestic policies? Discretion would be optimal when: countries have little ability to manipulate their terms-of-trade, they do not trade very much, and domestic policies are poor substitutes for tariffs. However, over time, the costs of discretion have likely risen as trade volumes have increased, the GATT/WTO seeking actively to regulate domestic policies.²²⁹

B. An Incomplete Contract

Much has been written about the GATT/WTO being an incomplete contract, with commentators observing this was recognized in the lead up to and the original drafting of the GATT.²³⁰ For example, the Nobel Prize winning economist James Meade emphasized, in what is considered an early draft of the GATT, that it would need to reflect a trade-off between a complete and rigid contract versus relying on a mechanism to interpret the contract in the presence of disputes,

“...The success of the Union will depend on the formulation of the Charter in terms which, on the one hand, do not attempt to put international trade in an impossible straitjacket and, on the other hand, do not impose upon the International Commerce Commission such a burden of semi-legislative duties that it could not bear...”²³¹

²²⁶ See *Id.* at 398.

²²⁷ See *Id.* at 400. See also Brian R. Copeland, *Strategic Interaction among Nations and Non-Negotiable Trade Barriers*, 23 *CANADIAN J. ECON.* 84, 106 (1990).

²²⁸ See Staiger, *supra* note 216, at 50-51.

²²⁹ See Horn *et al.*, *supra* note 224, at 396.

²³⁰ See Staiger, *supra* note 216, at 100.

²³¹ See James E. Meade, *A Proposal for an International Commercial Union*, reproduced in 10 *WORLD ECONOMY* 400, 404 (1987).

In the context of this paper, the non-violation clause of GATT has been described as “...Exhibit A for the proposition that the GATT/WTO is an incomplete contract...”²³² The non-violation clause was given prominence by the original drafters of the GATT and was re-affirmed upon creation of the WTO.²³³ In simple terms, this clause allows a GATT/WTO member to seek compensation from another member whose domestic policies, while not specified in the contract, have adverse trade effects. The fact the GATT/WTO contains such a clause emphasizes its incomplete nature as well as its shallow- integration approach.²³⁴

C. Domestic Policies and No Disputes

One approach to analyzing the non-violation clause of GATT/WTO is to consider whether it might allow replication of a complete contract through tariff bindings alone. For example, in what way does the threat of a non-violation complaint restrict a country’s sovereignty over its domestic policies such as setting environmental standards? Returning to the case of the countries importing x and y , if the contract between them consists only of binding their tariffs, and at the same time they have unrestricted sovereignty over their domestic policies, they each have an incentive to distort their environmental standards to influence their terms-of-trade.

However, introduction of the non-violation clause restricts their sovereignty to policy combinations that do not reduce market access for x and y below that implied by each country’s tariff commitments.²³⁵ To see this, think of contract negotiations between the two countries occurring over two stages. For initial environmental standards, Stage 1 involves bargaining over tariffs, implying world relative prices, and market access commitments for x and y . At Stage 2 each country can adjust its trade and environmental standards, subject to their applied tariffs not exceeding their bound tariffs from stage 1, and changes in their environmental standards do not erode their implied market access commitments. For example, final equilibrium might require both countries to set applied tariffs below their bound tariffs and reduce their environmental standards to avoid a non-violation complaint.²³⁶ Alternatively, final equilibrium might require both countries to set tariffs above the bound level along with higher environmental standards, in which case, under GATT Article XXVIII, tariff bindings would have to be renegotiated, i.e., a reciprocal reduction in market access that leaves each country’s terms -of-trade unchanged.²³⁷ While beyond the focus of this paper, the latter case has considerable relevance to the ongoing debate over the WTO-legality of carbon tariffs in the presence of domestic carbon taxes.²³⁸

²³² See Robert W. Staiger and Alan O. Sykes, *How Important Can the Non-Violation Clause be for the GATT/WTO?*, 9 AM. ECON. J.: MICROECONOMICS 149, 149 (2017).

²³³ See Id. at 150.

²³⁴ See Id. at 184.

²³⁵ See Kyle Bagwell and Robert W. Staiger, *Domestic Policies, National Sovereignty, and International Economic Institutions*, 116 QUARTERLY J. ECON. 519, 544-45 (2001).

²³⁶ See Id. at 551-52.

²³⁷ See Id. at 551-52.

²³⁸ See Steve McCorrison and Ian M. Sheldon, *Market Access and WTO Border Tax Adjustments for Environmental Excise Taxes Under Imperfect Competition*, 7 J. PUB. ECON. THEORY 579, 580-81 (2005).

Subsidies can also be analyzed within this type of framework, setting the scene for later discussion of China's use of industrial subsidies. From the standpoint of economic theory, production subsidies are not necessarily a distorting policy instrument if used to target some type of market failure such as under-provision of research and development (R&D).²³⁹ They are also a first-best instrument by the targeting principle, i.e., the market failure should be directly targeted at source.²⁴⁰ Therefore, there is the potential that proscription of subsidies will lead to a second-best outcome if governments then use import tariffs and other policies instead.²⁴¹

Notwithstanding economic theory, as noted previously, the original GATT rules provided two routes by which a country could target other countries' use of subsidies. First, if a subsidy were offered to exporters which then affected a country's import-competing producers, under GATT Article XVI, a countervailing duty could be targeted unilaterally against the subsidized exports. Second, if the subsidy were offered to import-competing firms, under Article XXIII a country would have recourse to filing a non-violation nullification or impairment complaint on the grounds the subsidy negated previous concessions on market access. These latter disciplines were tightened in the Tokyo Round of GATT through the plurilateral Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the GATT (the "Subsidies Code") with export subsidies (excluding those in agriculture) deemed a *per se* violation of the rules.²⁴² Finally, the Uruguay Round of GATT led to the SCM. Importantly, the Agreement defined a subsidy as a "financial contribution" from a "government or public body" that confers a "benefit" on the firm receiving it (SCM Article 1).

Focusing again on the two-country/two-good case, assume the country importing x has three policy instruments at their disposal: a tariff, a production subsidy, and a consumption tax, while the other country utilizes an import tariff, and the potential to make a non-violation claim, which is assumed costly. Under the original GATT rules on use of subsidies, the contract between the two countries can be thought of as a three-stage game. At Stage 1, the two countries bargain over tariffs, given initial subsidy and tax policies in the country importing x , implying world relative prices, and market access commitments for x and y . Then at Stage 2, the tariff, subsidy, and tax policies can be adjusted by the country importing x , which again implies world relative prices, and a market access commitment for x . Finally at Stage 3, if the country exporting x faces reduced market access, it can file a non-violation claim, but if it wins that claim, the importing country is not obliged to remove the subsidy but import market access must be restored to its Stage 1 level. Essentially, there is an equilibrium to this type of game if the country importing x sets its policies at Stage 2 to preserve its market access commitment implied by its Stage 1 tariff-choice, i.e., there will be no dispute.²⁴³

²³⁹ See Chad P. Bown and Jennifer A. Hillman, *WTO'ing a Resolution to the China Subsidy Problem*, 22 J. INT'L ECON. LAW 557, 557-58, 560 (2019).

²⁴⁰ See Jagdish Bhagwati and V.K. Ramaswami, *Domestic Distortions, Tariffs and the Theory of Optimum Subsidy*, 71 J. POL. ECON. 44, 44-46 (1963).

²⁴¹ See Kyle Bagwell and Robert W. Staiger, *Will International Rules on Subsidies Disrupt the World Trading System?*, 96 AM. ECON. REV. 877, 877 (2006).

²⁴² See Bown and Hillman, *supra* note 239, at 560-61.

²⁴³ See Bagwell and Staiger, *supra* note 241, at 885-87.

Under SCM, an additional stage is added between Stages 2 and 3 of the game, allowing the country exporting x to challenge the production subsidy set by the other country at Stage 2, the equilibrium of the game depending on the policy mix for the country importing x . Even if a consumption tax is available, reaching an efficient contract is less likely because of the constraints placed on the production subsidy at Stage 3, i.e., the remaining policy instruments are insufficient to reach an equilibrium.²⁴⁴ Alternatively, if the consumption tax is unavailable, the country exporting x can guarantee an equilibrium by challenging any production subsidy under SCM. However, if a production subsidy really matters in terms of targeting a market failure in the country importing x , there is that risk tariff negotiations will be undermined.²⁴⁵

While this approach to thinking about domestic policies does allow for efficient breach of a trade agreement, i.e., an importing country can maintain a domestic policy if market access commitments implied by tariff bargaining are maintained, no disputes occur in equilibrium. Using game-theoretic parlance, the negotiating game has a perfect equilibrium because the threat of a non-violation claim by the exporting country is credible, i.e., disputes are never observed because making non-violation claims lies off the equilibrium path.²⁴⁶ Therefore, to complete the analysis, and also provide background to the thinking about U.S.-Chinese trade relations, there should be potential for disputes to occur in equilibrium, along with a range of possible outcomes for those disputes.

D. Domestic Policies and Disputes

Analysis of trade agreements has typically focused on enforcement as opposed to dispute settlement.²⁴⁷ However, progress has been made recently in developing models predicting the likelihood and outcome of trade disputes.²⁴⁸ Suppose prior to contracting, there is *ex ante* uncertainty about future states of the world, for example there could be an unexpected import surge in some future period. Given this uncertainty, the countries importing and exporting good x negotiate an incomplete contract over the former's trade policy, but not its domestic policy.²⁴⁹ In addition, the countries settle on the mandate for a DSB, and in doing so, they agree not to resort to unilateral retaliation, thereby forgoing "vigilante justice".²⁵⁰

Once the state of the world is known, the country importing x chooses its trade and domestic policies, the possible combinations being either free trade, protection through a tariff, or protection via domestic policy. For simplicity the country exporting x makes no policy choice. The importing country derives positive economic payoff from its policy choice through

²⁴⁴ See *Id.* at 888-89.

²⁴⁵ See *Id.* at 890-91.

²⁴⁶ See Robert W. Staiger and Alan O. Sykes, *Non-Violations*, 16 J. INT'L ECON. LAW 741, 760-61 (2013).

²⁴⁷ See Giovanni Maggi and Robert W. Staiger, *Trade Disputes and Settlement*, 59 INT'L ECON. REV. 19, 20 (2018); see also Giovanni Maggi and Robert W. Staiger, *The Role of Dispute Settlement Procedures in International Trade Agreements*, 126 QUARTERLY J. ECON. 475, 475-80 (2011).

²⁴⁸ See *id.* at 19-23; see also Staiger and Sykes, *supra* note 232, at 156.

²⁴⁹ See *id.* at 156.

²⁵⁰ See *id.* R 164; see also Staiger, *supra* note 216, at 115.

manipulation of its terms-of-trade and any domestic political-economic benefits,²⁵¹ domestic policy being an imperfect substitute for trade policy. The exporting country derives a negative economic payoff from the importing country's policy choices, the latter being transmitted via trade effects. At this point, there could be *ex post* negotiation between the two countries over their joint economic payoff implied by the importing country's policy choices, with the potential for compensation, i.e., "bargaining in the shadow of the law".²⁵²

If the two countries fail to reach a bilateral agreement, at a cost to both, they can then seek a ruling from the DSB, which observes the state of the world but receives a noisy signal about the joint payoff to the two countries, i.e., there is a positive probability the DSB will make an incorrect ruling. The DSB addresses a violation complaint if the importing country imposes a tariff, ruling in favor of free trade if the joint payoff is negative, which is then automatically enforced, i.e., a "property rule".²⁵³ In the current context, a property rule assigns ownership of rights over trade policy to one of the contracting parties, i.e., specifically, the right to free trade is granted to the exporting country.²⁵⁴

Alternatively, the DSB addresses a non-violation complaint under one of two circumstances: either as back-up to a violation complaint that it rules against, or as a standalone complaint if the importing country applies a domestic policy, the DSB ruling in favor of free trade if the joint payoff is negative. In either case, the country importing x can choose to implement the DSB ruling, or it can retain either its trade or domestic policy and provide DSB-set damages payable to the exporting country, i.e., a "liability rule" allowing for breach of contract.²⁵⁵ Note, the damages do not necessarily fully cover the negative payoff to the exporting country due to transfer costs. This reflects the fact that direct compensation rarely occurs between countries in trade disputes, instead the exporting country is typically allowed "self-help" compensation in the form of reciprocal tariff retaliation, which necessarily comes with a deadweight cost.²⁵⁶ In other words, the liability rule mimics the concept in law and economic analysis of efficient breach but it is imperfect.²⁵⁷ While not the focus here, there has been considerable discussion of the choice between the use property and liability rules over time

²⁵¹ See Gene M. Grossman and Elhanan Helpman, *Protection for Sale*, 84 AM. ECON. REV. 833, 833-35 (1994).

²⁵² See Maggi and Staiger, *supra* note 247, at 20.

²⁵³ See Schwartz and Sykes, *supra* note 201, at S188-S189.

²⁵⁴ See Giovanni Maggi and Robert W. Staiger, *Optimal Design of Free Trade Agreements in the Presence of Renegotiation*, 7 AM. ECON. J. MICROECONOMICS 109, 111 (2015).

²⁵⁵ See Staiger and Sykes, *supra* note 232, at 162.

²⁵⁶ See *Id.* at 152.

²⁵⁷ See *Id.* at 162. For further legal-economic discussion of property versus liability rules, see for example: Guido Calabresi and A. Douglas Melamed, *Property Rules, Liability Rules and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972); see also, Louis Kaplow and Steven Shavell, *Property Rules versus Liability Rules: An Economic Analysis*, 109 HARV. L. REV. 713 (1996).

in the GATT/WTO,²⁵⁸ the conditions determining which rule is optimal,²⁵⁹ and also the connection between the timing of settlements and rule type.²⁶⁰

This analysis predicts a no-dispute, and hence an efficient outcome, only if the probability of the DSB making an inaccurate ruling is very low, i.e., the off-equilibrium path – a result like that described earlier where there is no *ex ante* uncertainty.²⁶¹ Therefore, a dispute arises on the equilibrium path because one of the countries is acting opportunistically to take advantage of an incomplete contract and ruling inaccuracy of the DSB, e.g., the importing country is trying to “get away” with using distorting policy instruments when in fact free trade is optimal.²⁶² In addition to the DSB’s probability of ruling correctly in a dispute, the frequency of disputes and the types of claim(s) made, will depend on the costs to countries of engaging in dispute settlement, the extent of transfer costs, and the substitutability of trade and domestic policies. Specifically, the exporting country’s incentive to file a non-violation complaint is conditioned by the level of recoverable damages specified under DSB-rules, and the extent of transfer costs, while the importing country’s incentive to use domestic policies is constrained by their substitutability for trade policy.²⁶³

VI.

THE U.S.-CHINA TRADE DISPUTE: THE CASE FOR A NON-VIOLATION CLAIM

A. Revisiting the Dispute

To place the shift by the United States to “power-based” bargaining in context, it is key to see how the “rules-based” approach offered by the GATT/WTO has until now effectively neutralized any imbalance in bargaining power between countries. Starting from an initial high tariff equilibrium before any trade agreement is struck, there is a set of lower tariffs that would make both countries better off in equilibrium. However, in seeking a contract, suppose a country such as the United States with bargaining power, pushes for a new tariff equilibrium making it better off at the expense of another country. At this point trade negotiations break down, the other country incurring relationship-specific sunk costs from participating in tariff negotiations.²⁶⁴ In other words, the country with less bargaining power would have been better off never actually entering the negotiations. In contrast, under “rules-based” bargaining with reciprocity, the eventual tariff equilibrium should improve on the initial Nash equilibrium. Importantly, a country such as the United States with bargaining power, has had an incentive to

²⁵⁸ See Schwartz and Sykes, *supra* note 201, at S188-S192; see also Joost Pauwelyn, *OPTIMAL PROTECTION OF INTERNATIONAL LAW: NAVIGATING BETWEEN EUROPEAN ABSOLUTISM AND AMERICAN VOLUNTEERISM* (2008).

²⁵⁹ See Maggi and Staiger, *supra* note 254, at 112.

²⁶⁰ See Maggi and Staiger, *supra* note 247, at 28-36.

²⁶¹ See Bagwell and Staiger, *supra* note 241, at 551-54; see also Staiger and Sykes, *supra* note 187 at 170-71.

²⁶² See *Id.* at 171.

²⁶³ See *Id.* at 175.

²⁶⁴ See Mattoo and Staiger, *supra* note 182, at 571; see also John McLaren, *Size, Sunk Costs, and Judge Bowker’s Objection to Free Trade*, 87 AM. ECON. REV. 400, 402 (1997).

commit to a “rules-based” approach, to get weaker countries to engage in trade negotiations.²⁶⁵ As previously noted, with countries following a “rules-based” approach, successive rounds of trade liberalization since the formation of the GATT in 1947 have moved tariffs from the Nash equilibrium towards lower average tariffs.

Why then did the United States switch to “power-based” bargaining against China in 2018? The following rationalization has been offered under the rubric of China being an example of the “latecomer’s problem”: specifically, when China acceded to the WTO in 2001, it was offered the tariff level already committed to by existing GATT/WTO members, but China was able to set a higher best-response tariff to maximize its own economic well-being.²⁶⁶ The U.S. response to this lack of uniformity in tariffs has been to argue in favor of “full” reciprocity in trade negotiations where tariffs are reduced to the same level as opposed to the GATT/WTO approach of “first-difference” reciprocity based on mutual concessions on market access.²⁶⁷

Given the asymmetry between U.S. and Chinese tariffs, the United States raised its tariff against China in the expectation a bilateral agreement would be reached where China reduced its tariffs from their bound level. The logic for doing this was that, because China ran a large bilateral trade surplus with the United States, such “bargaining” tariffs represented a strong U.S.-threat point. This of course assumed China was unable to present a credible threat by responding with their own tariff increase.²⁶⁸ In fact, it was perfectly rational for China to punish the United States for having unilaterally raised its tariffs by raising its own tariffs.

B. Bargaining in the “Shadow of the Law”

In the context of the previous analysis, before signing USCTA, both parties resorted to “vigilante justice” in their response to each other’s unilateral tariff increases over the period 2018-19. The United States completely ignored the WTO’s dispute settlement process by initially targeting a broad range of tariffs against China, and although the latter pursued a violation complaint in response, they still implemented their own retaliatory tariffs against the United States over the same period. Basically, the two largest economies in the world chose to go back to the “... ‘law of the jungle’ in international economic affairs...”²⁶⁹, pushing their joint tariff equilibrium back towards the Nash equilibrium.

Even assuming the United States had legitimate reasons for unilaterally withdrawing its previous market access commitments to China, any “damages” it received through this action have clearly come at a significant deadweight cost.²⁷⁰ In addition, the incidence of U.S. tariffs was almost entirely borne by U.S. consumers, which is a somewhat surprising result given the growing empirical support for both the idea importing countries have market power, and the

²⁶⁵ See Jackson, *supra* note 208, at 157-59.

²⁶⁶ See Mattoo and Staiger, *supra* note 182, at 567-568.

²⁶⁷ See Daniel C.K. Chow and Ian M. Sheldon, *Is Strict Reciprocity Required for Fair Trade?*, 52 VAND. J. TRANS. L. 1, 33-34 (2019).

²⁶⁸ See Mattoo and Staiger, *supra* note 182, at 568-569.

²⁶⁹ See Staiger, *supra* note 216, at 33-34.

²⁷⁰ See Amiti *et al.*, *supra* note 185, at 187-189; see also Fajgelbaum *et al.*, *supra* note 186, at 42-45.

terms-of-trade theory of trade agreements.²⁷¹ Over a longer time period, it might be expected exporters would eventually cut before-tariff prices, especially if there was resolution of exporter uncertainty about how long the tariffs will remain in place.²⁷² Interestingly, a follow-up study with data for 2019, finds some variation across sectors, e.g., U.S. tariffs led foreign steel exporters to lower their before-tariff prices.²⁷³

The United States and China resorting to “vigilante justice” was eventually put on hold through negotiation of USCTA, which in some sense is analogous to the idea of the two countries choosing to bargain in the “shadow of the law”, i.e., a bilateral trade agreement signed without appeal to WTO dispute resolution. As previously noted, USCTA’s substantive feature was China’s import commitments for the period 2020-21, a commitment that has received considerable public and political attention. However, USCTA contains other chapters covering protection of intellectual property, technology transfer, non-tariff barriers to agricultural trade, financial services, exchange rates, and dispute resolution.²⁷⁴ It is too early to evaluate the impact of these chapters of USCTA, but conspicuous by its absence is any mention of disciplines on SOEs and China’s use of subsidies.

It might be argued China has provided compensation to the United States for its domestic policies, but it seems unlikely that this constituted efficient breach. At the time the import commitments were made, they were characterized as voluntary export expansion (VIEs) that would be difficult for SOEs to meet under a regime of managed trade.²⁷⁵ Two interdependent factors were considered to militate against SOEs satisfying the import targets. First, private trading firms have been mostly responsible for Chinese imports, SOEs purchasing only 26 percent of Chinese imports in 2019.²⁷⁶ Second, despite the USCTA, China did not formally reduce its retaliatory tariffs. Instead on February 17, 2020, the Chinese Ministry of Finance established a process by which tariff exemptions could be requested. At present, it is unclear how many exemptions were made and subsequently accepted, by which firms in which industries, and firm-type (private *vs.* SOE).²⁷⁷ If the objective of the United States is to push the China towards becoming a market economy, the solution offered by USCTA appears inefficient with associated deadweight costs.

C. Violation vs. Non-Violation Complaint?

²⁷¹ See Broda *et al.*, *supra* note 214, at 2032-34; see also Bagwell and Staiger, *supra* note 214, at 1238-41.

²⁷² See Staiger, *supra* note 216, at 99.

²⁷³ See Mary Amity, Stephen J. Redding, and David E. Weinstein, *Who’s Paying for the U.S. Tariffs? A Longer-Term Perspective*, AEA Papers and Proceedings 541, 541 (2020).

²⁷⁴ See USCTA, *supra* note 16.

²⁷⁵ See Robert Feenstra and C. Hong, *China’s Import Demand for Agricultural Products: The Impact of the Phase One Trade Agreement*, Review of International Economics Online, 345, 345-347 (2022); see also Chad P. Bown and Mary E. Lovely, *Trump’s Phase One Deal Relies on Chinese State-Owned Enterprises*, Trade and Investment Policy Watch, Peterson Institute for International Economics (March 3, 2020). <https://www.piie.com/blogs/trade-and-investment-policy-watch/trumps-phase-one-deal-relies-chinas-state-owned-enterprise>.

²⁷⁶ See *Id.*

²⁷⁷ See Bown, *supra* note 219, at 830.

At the time of its accession to the WTO in 2001, China's trading partners believed its tariff bindings and eventual shift to a market-based economy meant that it would meet its WTO market access commitments, and if it were to deviate from its obligations, a violation complaint(s) could be/have been filed and litigated successfully under GATT/WTO Article XXIII 1(a), i.e., the WTO would work as designed.²⁷⁸ Since 2001, "China Inc." has evolved to the point where China's domestic policies likely act as a substitute for its trade policy, undermining the market access commitments and obligations they signed up for.²⁷⁹ While China has adopted a variety of domestic policies, the focus here is on subsidies. In Congressional testimony, former member of the Appellate Board Jennifer Hillman argued that China has violated two key commitments it made in acceding to the WTO: first, it has failed to notify the WTO of all subsidies it has granted or maintained, and second, it has not eliminated all export and import substitution subsidies.²⁸⁰

Despite convincing arguments that a broad coalition of WTO member countries should file a violation complaint against China, detailed assessment of the SCM suggests it is practically ineffective as it suffers from both definitional and evidentiary problems.²⁸¹ First, as noted previously, China challenged U.S. use of countervailing duties against exports involving SOE support, on the grounds these were not subsidies from a "public body." The Appellate Board subsequently ruled a "public body" means governments or government entities, thereby removing SOEs from the WTO definition of a subsidy.²⁸² Second, there is a heavy burden of proof on complaining countries to show there is governmental control over an entity, and that the latter is providing a subsidy. Therefore, applying SCM disciplines in the context of "China Inc." is likely to prove difficult. In addition, even if a challenge can be proven, the WTO is unable to issue retrospective remedies for past harm, i.e., China gets a "free pass" for breach of the SCM before any dispute is ruled on.²⁸³ The conclusion to be drawn here is that it makes sense for the United States and other WTO members to file a wide-ranging violation complaint against China, recognizing that its chances of success are likely constrained by the yet unsolved issue of defining subsidies and how they may undermine negotiated market access

²⁷⁸ See Jennifer Hillman, *The Best Way to Address China's Unfair Policies and Practices is Through a Big, Bold Multilateral Case at the WTO*, Testimony Before the U.S.-China Economic and Review Security Commission, Hearing on U.S. Tools to Address Chinese Market Distortions at 3 (June 8, 2018), <https://www.uscc.gov/sites/default/files/Hillman%20Testimony%20US%20China%20Comm%20w%20Appendix%20A.pdf>.

²⁷⁹ See Staiger, *supra* note 216, at 126-27.

²⁸⁰ See Hillman, *supra* note 278, at 6-7.

²⁸¹ See Bown and Hillman, *supra* note 239, at 567-70.

²⁸² *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R (Report of the Appellate Body adopted on Mar. 11, 2011); see also Dukgeun Ahn, *Why Reform is Needed: WTO 'Public Body' Jurisprudence*, 12 GLOBAL POLICY 3 (2021) for a detailed discussion of this ruling by the Appellate Body.

²⁸³ See Mark Wu, *China's Rise and the Growing Doubts over Trade Multilateralism* in TRADE WAR: THE CLASH OF ECONOMIC SYSTEMS ENDANGERING GLOBAL PROSPERITY 107 (Meredith A. Crowley Ed. 2019); see also Chad P. Bown, *Trump Ended WTO Dispute Settlement. Trade Remedies are Needed to Fix It*, 21 WORLD TRADE REV. 312, 323-24 (2022).

Alternatively, both legal and economic analysts have suggested the non-violation clause GATT/WTO Article XXIII 1(b) should/could be used more aggressively against China.²⁸⁴ As already discussed, this clause is designed to allow a country(ies) to seek compensation from another country for the adverse market access effects of their domestic policy choices, even if the latter are not explicitly in violation of specific WTO obligations such as SCM.²⁸⁵ Essentially, the non-violation clause is acknowledgement that GATT/WTO is an incomplete contract, i.e., not all domestic policy choices are covered by the rules, with the attendant risk of the trade bargain being undermined.²⁸⁶

As noted earlier, while concerns have been expressed by economists about the efficacy of current GATT/WTO rules on subsidies,²⁸⁷ they do have the potential to undermine market access commitments. To that end, it has been argued that an affected country could seek redress through the non-violation clause, either through withdrawal of the subsidy or compensation.²⁸⁸ However, some commentators have pushed this idea further by arguing that the focus should be on China's departure from their market access commitments rather than use of any specific domestic policies such as subsidies.²⁸⁹ Quoting Hillman on the possibility of the United States and other WTO members pursuing a non-violation claim,

“...It is this collective failure of China, rather than any specific violation of individual provisions, that should form the core of a big bold WTO case. Because addressing these cross-cutting, systemic problems is the only way to correct for the collective failures of both the rules-based trading system and China...”²⁹⁰

While non-violation claims under GATT/WTO have been rare,²⁹¹ it has been argued they could provide China with the ability to decide how to make commitments on market access to the United States and other trading partners that would re-establish reciprocity, but if those commitments are insufficient, previous concessions on market access can then be withdrawn.²⁹² Importantly, compared to the “power-based” bargaining approach to “China Inc.” of the Trump administration, utilizing the non-violation clause returns resolution of market access issues and reciprocity to the “rules-based” multilateral system. In addition, rather than presenting China with the choice of either moving towards a market-economy or leaving the WTO as has been suggested by some,²⁹³ the non-violation clause gives China the flexibility to augment the

²⁸⁴ See Hillman, *supra* note 278, at 10-11; see also Staiger, *supra* note 216, at 130-34.

²⁸⁵ See Staiger and Sykes, *supra* note 232, at 149.

²⁸⁶ See Staiger, *supra* note 216, at 117.

²⁸⁷ See Bagwell and Staiger, *supra* note 241, at 877-79.

²⁸⁸ See Alan O. Sykes, *The Economics of WTO Rules on Subsidies and Countervailing Measures*, John M. Olin Law & Economics Working Paper No. 186, University of Chicago Law School, 17-18 (2003).

²⁸⁹ See Staiger, *supra* note 216, at 132-33.

²⁹⁰ See Hillman, *supra* note 278, at 11. Interestingly Wu, *supra* note 282, is considerably less optimistic about the merits of such an approach, dismissing a non-violation complaint as having too high a burden of proof to be successful. In addition, he regards the current WTO rules as being incomplete, and not well-designed to deal with “China Inc.” The solution he offers is for WTO members to seek a new modality for updating rules of the multilateral trading system. See *Id.* at 109.

²⁹¹ See Staiger and Sykes, *supra* note 246, at 743-44.

²⁹² See Staiger, *supra* note 216, at 132-33.

²⁹³ See Hillman, *supra* note 278, at 13.

commitments it made when acceding to the WTO, i.e., China could re-establish reciprocity without necessarily reforming its own economic system.²⁹⁴

Arguably, China could well see it in its own interests to facilitate such rebalancing.²⁹⁵ Of course how China augments its market access commitments is an open question, but there is precedent for this when non-market economies such as Hungary, Poland, and Romania joined the GATT in the 1960s and 1970s.²⁹⁶ The fact that China did sign up via the USCTA to import more from the United States suggests it is willing to make such commitments. However, the argument here is that making such commitments relies on the multilateral system as opposed to bilateral bargaining in the “shadow of the law”, i.e., the United States and its trading partners file a non-violation complaint against China, which is then ruled on by the DSB, after which China either re-commits to reciprocity or there is breach of contract with appropriate compensation to the United States and other WTO members.

VII. CONCLUSION

At present, the Biden administration has paused the U.S.-China trade battle by maintaining the uneasy status quo established by Trump era policies. The United States has no clear strategy for moving forward with its longstanding dispute with China about its failure to dismantle its state-led economy, which the United States claims was a condition of China’s accession to the WTO. The United States is particularly concerned with China’s use of industrial subsidies to support its business entities and the role played by China’s SOEs in serving as a conduit for providing state subsidies to sustain China’s industries. The Biden administration has indicated that it does not intend to complete Phase II of the USCTA, which was intended by the Trump administration to be an agreement on China’s subsidies and SOEs. The United States has also indicated that the WTO dispute settlement procedure is not suited to addressing China’s industrial subsidies and SOEs because these practices are supported by domestic policies that are outside the purview of the WTO, which focuses on border measures, not internal policies. U.S. trade policy towards China appears to be currently stalled without any clear direction forward.

This Article proposes a clear path forward for the United States: enlist the aid of the EU and Japan in bringing a non-violation case that challenges China’s domestic policies in favor of industrial subsidies. There are numerous advantages of this approach. As discussed in this Article, a violation case that challenges China’s subsidies faces the hurdle of the WTO’s interpretation of subsidies to exclude payments by SOEs. A non-violation case allows the United States to challenge China’s domestic policies, an action that is not likely possible using a violation case. The non-violation case also offers the possibility of a flexible solution subject to negotiation by the parties. The parties can reach a private bargain to resolve the dispute. One possibility, foreshadowed by the USCTA, is for China to provide compensation to the United

²⁹⁴ See Staiger, *supra* note 216, at 132.

²⁹⁵ See *Id.* at 133.

²⁹⁶ See *Id.* at 132. See Maciej Kostecki, *Hungary and GATT*, 8 J. WORLD TRADE LAW 401 (1974); see also Leah Haus, *The East European Countries and GATT: The Role of Realism, Mercantilism, and Regime Theory in Explaining East-West Trade Negotiations*, 45 INT’L ORGANIZATION 163 (1991).

States for damages caused by its domestic policies. Such a bargain is possible only in a non-violation case and is not possible if the United States brings a violation case instead.

The bargain reached by the parties might include China's ability to maintain its policies while offering compensation such as increased market access to U.S. imports. For example, China could lower tariffs on U.S. goods, which should result in higher trade volumes for the United States. A higher volume of U.S. exports to China will provide more revenue to the United States, compensating the United States for China's use of industrial subsidies. Another alternative is for China to make concrete commitments to purchase an agreed amount of U.S. goods and services. One major advantage of this approach is that China will be able to continue its domestic policies while satisfying U.S. demands. Such an approach acknowledges the reality that China is committed to its industrial policies and its support of SOEs and views these policies as matters of national sovereignty. China is not likely to revoke these policies no matter what any nation or organization, including the WTO, might demand. China has given every indication, including its "Made in China 2025" policy, that its domestic policies in favor of SOEs are sacrosanct and will propel the nation forward for the foreseeable future.

The approach suggested in this Article also allows the United States to proceed while the Appellate Body remains paralyzed. The addition of the EU to the case will lock China into the procedures of the MPIA and into appeals to the MPIA Interim Appellate Body. The MPIA will ensure that China will not be able to appeal any adverse decision in the non-violation case and launch the decision into a legal oblivion.

Finally, the suggested approach of this Article is a return to the rules-based approach of the GATT/WTO and the economic logic of the GATT/WTO that has been remarkably successful in reducing trade barriers for the past seventy-five years. The Trump administration repudiated this rules-based approach in favor of a power-based approach that imperils the WTO and the multilateral trading system. Returning to the rules-based approach of GATT/WTO rescues the global trading system from the law of jungle and vigilante justice of the Trump era policies that are still being maintained by the Biden administration. The suggested approach could also help to save the WTO from its current crisis and might also help to restore the GATT/WO multilateral trading system to a central role in promoting trade between the United States and China for the foreseeable future.