

FILING WTO VIOLATION AND NON-VIOLATION COMPLAINTS:
A POSSIBLE SOLUTION TO CHINA’S MARKET ACCESS COMMITMENTS?

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A key omission of the 2020 United States China Economic Trade Agreement (USCTA) was any chapter covering China’s use of subsidies and their market access commitments under the World Trade Organization (WTO). While USCTA did not result in U.S. and Chinese tariffs being returned to their pre-trade war bound levels, the commitments made by China to meet specific import targets over the period 2020-21, suggest it might be willing to re-establish reciprocity with the United States without necessarily reforming its current economic system. The argument presented in this article is that, while the United States should file both WTO violation and non-violation complaints against China, the latter, if successful could allow China to maintain its use of industrial subsidies subject to it either maintaining its market access commitments to the United States or providing the latter with some form of compensation.

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I. INTRODUCTION

Professor Daniel Chow’s accompanying article to this one, lays out the background to the signing of the United States China Trade Agreement (USCTA) in January of 2020, along with detailed analysis of the intellectual property chapter of USCTA, and a critique of its dispute resolution mechanism. Importantly, while USCTA contains chapters on other issues including technology transfer and exchange rates, it does not address China’s use of subsidies and their

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impact on market access. In this context, the argument presented in this article focuses on the case for the United States filing both violation and non-violation complaints at the World Trade Organization (WTO) against China. To develop the analysis, the article is broken down into the following sections: in section II, by way of background, the post-WWII success of the multilateral trading system is described, followed in section III by an outline of the effects on the U.S. economy and body-politic of the Chinese import shock; in section IV the U.S. resort to “power-based” bargaining against China is evaluated, with suggestions on how to deal with China’s economic model being presented in section V. Some final conclusions are drawn in section VI, key being the need to resolve the impasse in the WTO dispute settlement mechanism.

II. THE GATT/WTO AS A “RULES-BASED” TRADING SYSTEM

The “rules-based” multilateral trading system established under the General Agreement on Tariffs and Trade (GATT) and its successor the WTO is based on two pillars constraining exercise of bargaining power: reciprocity where member countries seek a balance of tariff concessions in trade negotiations, and non-discrimination through the most-favored nation (MFN) principle.^{1,2} These rules, along with the argument GATT/WTO has ensured resolution of a terms-of-trade prisoners’ dilemma,³ have resulted in progressive reduction of tariffs in the post-war period,⁴ and a substantial increase in the global volume of trade.⁵

By some simple metrics, the GATT, and its successor the WTO, has been a very successful institution of international governance.⁶ GATT/WTO has established a rules-based system for world trade based on a set of principles enshrined in the GATT Articles,⁷ along with a dispute settlement system,⁸ that have been universally accepted and respected by its members.⁹ Membership has grown from the 23 countries that signed the GATT in 1947 to 164 countries

¹ See John Jackson. 1989. *The World Trading System* (Cambridge, MA: MIT Press, 1989), 51.

² The MFN principle requires each WTO member to extend a trade benefit given to one country to all other members of the WTO, the purpose being to universalize benefits to all other WTO members and serve as an inducement to join the WTO. See Daniel C.K. Chow and Thomas J. Schoenbaum, *International Trade Law: Problems, Cases, and Materials* (New York, NY: Wolters Kluwer, 2017), 149-150.

³ For the original argument see Charles F. Bickerdike, “The Theory of Incipient Taxes,” *The Economic Journal* 16, no.64 (Dec. 1906): 529-535; see also Harry G. Johnson, “Optimum Tariffs and Retaliation,” *Review of Economic Studies* 21, no.2 (Jan.1953): 142-153, 142; and see also Kyle Bagwell, and Robert W. Staiger, 1999. “An Economic Theory of GATT,” *American Economic Review* 89, no.1 (Mar. 1999): 215-248, 216-217.

⁴ See Richard Baldwin, “The World Trade Organization and the Future of Multilateralism,” *Journal of Economic Perspectives* 30, no.1 (Winter 2016): 95-116, 98-101.

⁵ See Arvind Subramanian, and Shang-Jin Wei, “The WTO Promotes Trade, Strongly but Evenly,” *Journal of International Economics* 72, no.1 (May 2007): 151-175., 151-153.

⁶ See Kym Anderson, “Contributions of the GATT/WTO To Global Economic Welfare: Empirical Evidence,” *Journal of Economic Surveys* 30, no.1 (Feb. 2016): 56-9, 56-58.

⁷ See Chow and Schoenbaum, *International Trade Law*, supra note 2, at 26-29.

⁸ See Id., at 83-86.

⁹ See Baldwin, supra note 4, at 95.

today.¹⁰ Currently, WTO members account for more than 95 percent of both global trade and gross domestic product (GDP).¹¹ Over the 70 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,¹² although there is quite a bit of variation in the average level of applied tariffs across both countries and sectors.¹³

There have been several studies exploring the relationship between membership of the GATT/WTO and countries' trade flows. An initial finding came as something of a shock to trade economists: membership of the GATT/WTO was not correlated with increased trade flows as compared to non-member countries.¹⁴ Not surprisingly this generated follow-up research. A widely accepted study argues the impact of a country's membership of GATT/WTO will depend on three dimensions: first, what a country does with its membership; second, with which other countries a country negotiates; and, third, which products are covered in trade negotiations.¹⁵ The reported empirical results are consistent with these predictions: industrial countries participating in reciprocal trade negotiations have enjoyed a significant increase in trade, bilateral trade has been greater when both countries engage in tariff reduction as compared to when only one country does, and sectors such as agriculture that were not initially covered by trade negotiations exhibited little or no increases in trade.¹⁶ Subsequent empirical work finds countries' agricultural trade has been significantly increased by their membership of GATT/WTO.¹⁷

These results, confirmed by additional empirical studies,¹⁸ have been interpreted in the context of developing countries receiving special and differential treatment (SDT) under GATT/WTO rules.¹⁹ Specifically, developing-country members of GATT/WTO have been

¹⁰ See James P. Murphy and Carolan McLarney, "Regionalism and the Multilateral Trading System," in Angelo Presenza and Lori R. Sheehan (Eds.), *Geopolitics and Strategic Management in the Global Economy* (Hershey, PA: IGI Global, 2018), 1-18, 3.

¹¹ See Peter J. Williams, *A Handbook on Accession to the WTO* (Cambridge: Cambridge University Press, 2008), 9-10.

¹² See Jackson, *supra* note 1, at 74.

¹³ See Baldwin, *supra* note 4, at 99; see also Kyle Bagwell, Chad P. Bown, and Robert W. Staiger, "Is the WTO Passé?" *54 Journal of Economic Literature*, 54, no.4 (Dec. 2016): 1125-1231, 1131.

¹⁴ See Andrew K. Rose, "Do We Really Know That the WTO Increases Trade?" *American Economic Review* 94, no.1 (Mar. 2004): 98-114, 98.

¹⁵ See Subramanian and Wei, *supra* note 5, at 151-153; see also Michael Tomz, Judith L. Goldstein, and Douglas Rivers, "Do We Really Know That the WTO Increases Trade? Comment," *97 American Economic Review*, 97, no.5 (Dec. 2007): 2005-2018, 2005; and Christopher Balding, "Joining the World Trade Organization: What Impact?" *Review of International Economics*, 18, no.1 (Feb. 2010): 193-206, 193-194.

¹⁶ See *Id.*, at 151-153.

¹⁷ See Jason H. Grant and Kathryn A. Boys, "Agricultural Trade and the GATT/WTO: Does Membership Make a Difference," *American Journal of Agricultural Economics* 94, no.1 (Jan. 2012): 1-24, 1-3.

¹⁸ See Theo S. Eicher and Christian Henn, "In Search of WTO Trade Effects: Preferential Trade Agreements Promote Trade Strongly but Unevenly," *Journal of International Economics*, 83, no.2 (Mar. 2011): 137-153, 137-138.

¹⁹ See Kyle Bagwell and Robert W. Staiger, "Can the Doha Round be a Development Round? Setting a Place at the Table," in Robert C. Feenstra and Alan M. Taylor (Eds.), *Globalization in An Age of Crisis: Multilateral Cooperation in the Twenty-First Century* (Chicago, IL: Chicago University Press, 2014), 91-124, 92-95.

exempted from its reciprocity norm, i.e., developing countries have got a “free pass” by benefitting from any tariff cuts negotiated between industrialized countries under the MFN rule while not being required to cut their own tariffs. However, by not lowering their own tariffs, developing country resources were often retained in inefficient import competing sectors.²⁰ This effectively has acted as a tax on their export competing sectors, i.e., in trade negotiations, “...what you get is what you give....”²¹ The conclusion to be drawn from the extant empirical research is that membership of GATT/WTO can be characterized as the outcome of a cooperative game that has generated mutual benefits for its members in the form of increased trade volumes, and particularly for countries engaging in reciprocal tariff-cutting.

III. THE CHINA IMPORT SHOCK

The multilateral trading system just described faced a major challenge when the Trump administration instigated a trade war with China in 2018. The build up to this war should be placed in the context of the rapid growth in globalization in the two decades following China’s entry to the WTO in 2001.²² Prior to the 1990s, the flow of trade in goods was mostly between developed countries (the “North” versus developing countries, the “South”).²³ High-income countries accounted for 80 percent of world trade in 1985.²⁴ Specifically, countries with similar GDP/capita produced goods such as automobiles, constrained by economies of scale and the size of their own market, and then traded those goods with other high-income countries in a larger integrated market for similar but differentiated goods.²⁵ The view among economists is that trade within these industries with an expanded international market not only resulted in consumers benefiting from a greater variety of goods, but that it also helped minimize the costs to “losers,” as it is easier to reallocate resources within industries than to reallocate from one industry to another.²⁶ This reduced the impact of trade on the distribution of income.²⁷

With growth in trade accelerating after the Second World War, concerns were expressed in the 1980s about growing income inequality in the United States, reflected in the increasing gap between skilled and unskilled wages.²⁸ Critics of globalization put part of the blame on growing imports from low-wage developing countries in the global South.²⁹ However, empirical

²⁰ See *Id.*, at 95-99.

²¹ See *Id.*, at 99-100.

²² See David H. Autor, David Dorn, and Gordon H. Hanson, “The China Syndrome: Local Labor Market Effects of Import Competition in the United States,” *American Economic Review* 103, no.6 (Oct. 2013): 2121-2168, 2121-2125.

²³ See Gordon H. Hanson, “The Rise of Middle Kingdoms: Emerging Economies in Global Trade,” 26 *Journal of Economic Perspectives* 26, no.2 (Spring 2012): 41-64, 41-43; see also Daniel C.K. Chow, William McGuire, and Ian Sheldon, “A Legal and Economic Critique of President Trump’s China Trade Policies,” 79 *University of Pittsburgh Law Review* 79, no.2 (Winter 2017): 205-242, 216-219.

²⁴ See Hanson, *supra* note 23, at 42.

²⁵ See *Id.*, at 48.

²⁶ See Paul R. Krugman, “Intra-Industry Specialization and the Gains from Trade,” *Journal of Political Economy* 89, no.5 (Oct. 1981): 959-973, 970.

²⁷ See *Id.*, at 971

²⁸ See Paul R. Krugman, “Trade and Wages, Reconsidered,” *Brookings Papers on Economic Activity* (Spring 2008): 103-137, 104.

²⁹ See *Id.*, at 104.

analysis published in the early to mid-1990s concluded that the effects of North-South trade on U.S. income inequality were very modest.³⁰ By the start of the 2000s, the consensus among trade economists was that trade was not a key contributing factor in either declining employment in the U.S. manufacturing sector or rising income inequality.³¹ Economists argued that observed changes in the U.S. labor market were mainly due to technological change in the manufacturing sector, which complemented more-skilled workers, thereby driving up skilled relative to unskilled wages.³² For example, technological change through automation has reduced demand for less-skilled assembly jobs in manufacturing, while raising productivity and wages of more-skilled labor.

At the same time that economists reached a consensus that technological change was the main factor causing loss of U.S. manufacturing jobs, exports from “factory China” exploded.³³ Chinese exports gave skeptics a reason to question whether technological change or sharply rising exports from China was the cause of negative impacts on less-skilled labor.³⁴ Between 2000 and 2007, U.S. import penetration by low-wage countries grew from 15 to 28 percent, China’s share of this growth being 89 percent.³⁵ The value of US imports from China rose by 171 percent between 2000 and 2007, compared to growth in U.S. exports to China of 150 percent.³⁶ U.S. manufacturing faced a significant increase in Chinese import competition without an offsetting increase in exports – a pattern shared by virtually all industrial sectors.³⁷ This import shock was not unique to the United States, for example, China’s share of UK manufacturing imports rising from one to 8.6 percent over the period 1988-2007.³⁸

There is now a growing body of research examining the impact of the China import shock on U.S. employment and other metrics.³⁹ For example, one study found that extension by the United States of permanent normal trade relations (PNTR) to China in 2000 was associated with a sharp drop in U.S. manufacturing employment between 2000 and 2003, the effect being stronger in industries most affected by a reduction in uncertainty about tariff rates.⁴⁰ Other analysis measures the geographic exposure of labor markets across the United States to the

³⁰ See *Id.*, at 104.

³¹ See David H. Autor, David Dorn, and Gordon H. Hanson, “The China Shock: Learning from Labor Market Adjustment to Large Changes in Trade,” *Annual Review of Economics* 8 (Oct. 2016): 205-240, 207.

³² See Eli Berman, John Bound, and Stephen Machin, “Implications of Skill-Biased Technological Change: International Evidence,” *Quarterly Journal of Economics* 113, no.4 (Nov. 1998): 1245-1279, 1246-1247.

³³ See Autor, Dorn, and Hanson, *supra* note 31, at 208.

³⁴ See *Id.*, at 208.

³⁵ See Autor, Dorn, and Hanson, *supra* note 22, at 2122.

³⁶ See *Id.*, at 2122.

³⁷ See Autor, Dorn, and Hanson, *supra* note 31, at 212.

³⁸ See Italo Colantone and Piero Stanig, “Global Competition and Brexit,” *American Political Science Review* 112, no.2 (May 2018): 201-218, 202.

³⁹ See Justin R. Pierce and Peter K. Schott, “The Costs of US Trade Liberalization with China Have Been Acute for Some Workers,” in Meredith A. Crowley (Ed.), *Trade War: The Clash of Economic Systems Endangering Global Prosperity* (London: CEPR Press, 2019), 13-19, 14-16.

⁴⁰ See Justin R. Pierce and Peter K. Schott, “The Surprisingly Swift Decline of US Manufacturing Employment,” *American Economic Review* 106, no.7 (Jul. 2016): 1632-1662, 1632-1635.

increase in imports from China.⁴¹ As already noted, the “shock” feature of Chinese imports relates to the rapid rise primarily in manufacturing imports from China since the mid-1990s. The rising international competitiveness of China has been associated with increased openness in China that has allowed Western firms to outsource production activities to China, the relaxation of central planning, accession to the WTO in 2001 and possible manipulation of their exchange rate.⁴² Not only has the rise in China’s competitiveness given rise to concerns about “unfair” trade, but the extent and speed of the rise in imports from China has forced considerable adjustment in importing countries with the resulting impact on regional labor markets in importing countries where manufacturing activities are located.

Key to identifying the impact on labor is the definition of a labor “market”. Rather than assume labor is mobile within national borders, extant research has focused on commuting zones, defined as the distance workers would reasonably commute to work, with commuting zones being located across the United States.⁴³ A key feature that arises from using commuting zones as a unit of measurement is that labor does not have a strong tendency to change commuting zones. In other words, labor is not that mobile in contrast to what trade theory typically assumes.

By overlaying the industrial structure of U.S. commuting zones, analysis has gauged the impact of exposure these industries have to competition from Chinese imports. Since this matches the characterization of commuting zones, they are then able to assess the impact of the recent rise of China on local labor markets.⁴⁴ Since labor does not have a strong tendency to move, the impact of Chinese imports has been particularly strong across certain U.S. states: wages falling dramatically, women withdrawing from the workforce, there has been an increase in demand for social benefits and disability allowances and when workers re-engage in the same commuting zone, re-hiring has been at wages much lower than previous employment.⁴⁵ This has been the main feature of the “China shock”: the geography was felt dramatically in several, typically southern and eastern states while other states escaped the impact of the rise of China given the differences in industrial structure. In sum, the growth of China has had a significant effect on certain parts of the United States.

Analysis of the “China shock” has been extended to an examination of voting patterns across the U.S.⁴⁶ Using detailed data on voting in congressional and presidential elections, they report two main results. First, while accounting for other determinants of voting patterns, e.g., education, age, white collar etc., due to the dramatic rise in imports from China, voters were less likely to support moderate candidates of either political party. There was a swing to either end of the political spectrum reflecting an increase in polarization in the U.S. political environment. Second, in presidential elections, in the districts most exposed to competition from Chinese

⁴¹ See Autor, Dorn, and Hanson, *supra* note 22, at 2121-2125.

⁴² See Autor, Dorn, and Hanson, *supra* note 31, at 211-215

⁴³ See Autor, Dorn, and Hanson, *supra* note 22, at 2132.

⁴⁴ See *Id.*, at 2123.

⁴⁵ See *Id.*, at 2159.

⁴⁶ See David Autor, David Dorn, Gordon Hanson, & Kaveh Majlesi, “Importing Political Polarization? The Electoral Consequences of Rising Trade Exposure,” *American Economic Review* 110, no. 10 (Oct. 2020): 3139-3183, 3139-3145.

imports, the “China shock” was reflected in an increase in support for Republican candidates.⁴⁷ Although there may be other factors that have contributed to the divisiveness of U.S. politics in recent years, a clear link has been established between the impact of globalization and political outcomes and ties closely with the targeting of tariffs by the Trump administration. Both presidential candidates explicitly highlighted competition from China in their 2016 electoral campaigns, the results here suggesting that the competition from China favored the Republican candidate.

IV. U.S. TRADE BARGAINING

A. From a “Rules-Based” Trading System to “Power-Based” Bargaining

An interpretation of the trade war between the United States and China is the former switching from a “rules-based” to a “power-based” approach to trade negotiations, targeting higher “bargaining” tariffs at a country with which it has consistently run a bilateral trade deficit.⁴⁸ This switch in trade policy emphasis has been driven by several other 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 WTO rules.⁴⁹ A key component of this “power-based” approach is the United States has also disabled the dispute settlement system of the WTO by paralyzing its Appellate Body.⁵⁰

Superficially, “power-based” bargaining has worked: in signing USCTA on January 15, 2020,⁵¹ China committed 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, 2021.⁵² 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

⁴⁷ See *Id.*, at 3175-3176.

⁴⁸ See Aaditya Mattoo, and Robert W. Staiger, “Trade Wars: What do they Mean? Why are they Happening Now? What are the Costs?” *Economic Policy* 35, no.103 (Jul. 2020): 561-584, 573-576; see also Ian M. Sheldon, “The United States’ Power-Based Bargaining and the WTO: Has Anything Really Been Gained?” *Applied Economic Perspectives and Policy* (forthcoming, 2022), 1-16, 14.

⁴⁹ See Wayne M. Morrison, *China-U.S. Trade Issues*, (Washington DC: Congressional Research Service, 2018), 29-54.

⁵⁰ See Joost Pauwelyn, “WTO Dispute Settlement Post 2019: What to Expect?” *Journal of International Economic Law* 22, no.3 (Sep. 2019): 297-321, 297-300.

⁵¹ See Office of the United States Trade Representative (USTR), *Economic and Trade Agreement between the Government of the United States of America and the Government of the People’s Republic of China*. (Washington DC: USTR, 2020).

[https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/Economic And Trade Agreement Between The United States And China Text.pdf](https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/Economic%20And%20Trade%20Agreement%20Between%20The%20United%20States%20And%20China%20Text.pdf).

⁵² See Chad P. Bown, “US-China Phase One Tracker: China’s Purchases of US Goods,” *PIIE Charts* (Washington DC: Peterson Institute for International Economics, July 19, 2022).

<https://www.piie.com/research/piie-charts/us-china-phase-one-tracker-chinas-purchases-us-goods>.

their two-year commitment.⁵³ In the case of the agricultural and manufacturing sectors, China reached 83 and 59 percent respectively of their two-year commitments.

At the time these commitments were made, they were characterized as VIEs,⁵⁴ that would be difficult for Chinese state-owned enterprises (SOEs) to meet under a regime of managed trade.⁵⁵ 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 2019.⁵⁶ 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. It is unclear how many exemptions have been made and subsequently accepted, by which firms in which industries, and firm-type (private *vs.* SOE).⁵⁷ Essentially, imports would be based on choices made by the Chinese government.

Compared to the metric of bound MFN tariffs, proving China has deliberately not met its import commitments runs up against the counterfactual that substantial shocks to demand, and supply are likely to have affected the outcome.⁵⁸ In terms of its import commitments, China clearly underperformed relative to the target(s), although this should be placed in the context of how the COVID-19 pandemic has affected global trade flows. Analysis of the pandemic indicates agricultural trade has been resilient compared to trade in manufactured products,⁵⁹ China accounting for 95 percent of the observed \$20 billion increase in world agricultural trade in 2020.⁶⁰ The import demand shock, especially for grain and soybean-use in animal feed, has been driven by China rebuilding its hog production capacity devastated by African Swine Fever in 2018. Critically, Chinese tariff exemptions on agricultural imports appear to be fundamentally

⁵³ See Chad P. Bown, “China Bought None of the Extra \$200 billion of US Exports in Trump’s Trade Deal,” *Realtime Economic Issue Watch* (Washington DC: Peterson Institute for International Economics, February 8, 2022), 1. <https://www.piie.com/sites/default/files/documents/bown-china-us-exports-trade-deal-2022-02.pdf>.

⁵⁴ 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* Published online 30, no.1 (Feb 2022): 345-368, 345-347.

⁵⁵ Chad P. Bown and Mary E. Lovely, “Trump’s Phase One Deal Relies on Chinese State-Owned Enterprises,” *Trade and Investment Policy Watch* (Washington DC: 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>.

⁵⁶ See Id.

⁵⁷ See Chad P. Bown, “The US-China Trade War and Phase One Agreement” *Journal of Policy Modeling* 43, no.4 (Jul-Aug. 2021): 805-843, 812-818.

⁵⁸ See Chad P. Bown, “Trump Ended WTO Dispute Settlement. Trade Remedies are Needed to Fix It,” Working Paper 22-1 (Washington, DC: Peterson Institute for International Economics, January 2022). <https://www.piie.com/publications/working-papers/trump-ended-wto-dispute-settlement-trade-remedies-are-needed-fix-it>.

⁵⁹ See Bown, *supra* note 52.

⁶⁰ See Shawn Arita, Jason Grant, Sharon Sydow, and Jayson Beckman, “Has Global Agricultural Trade Been Resilient Under Covid-19? Findings from an Econometric Assessment of 2020,” *Food Policy* 107, no.2 (Feb. 2022), 1-23, 9.

market-driven, i.e., it is a stretch to claim U.S. “power-based” bargaining has worked exclusively because of a trade agreement centered on VIEs.

Bringing China to the trade negotiating table, has also come at considerable actual and potential cost,^{61,62} and does not substantively contribute to resolution of a fundamental problem facing the WTO: how to deal with China’s current economic model. To paraphrase the prescient testimony of former Appellate Board member Jennifer Hillman to the U.S.-China Economic and Review Security Commission in 2018, the U.S. has not avoided “...a narrow, deficit-focused bilateral deal...”⁶³

B. The Cost of “Power-Based” Bargaining

With respect to the United States’ imposition of tariffs on China, the economists’ case against protection, which can be found in any undergraduate textbook on international trade, is at once both straightforward and nuanced.⁶⁴ The standard view is a country choosing protection will suffer a loss in national welfare as measured by a reduction in its GDP. This follows from the fact that tariffs provide an incentive for resources to remain in inefficient import-competing sector(s) rather than being reallocated to more efficient export-competing sector(s), i.e., the classic economic gains from specialization are foregone.⁶⁵ In addition, tariffs result in significant distributional effects between both consumers and firms, as well as consumers and the government, consumers paying a higher price for goods produced domestically as well as paying tariffs on imported goods.⁶⁶ The net effect is that consumers end up losing more than domestic firms and the government exchequer gain, i.e., there is “deadweight” loss from protection.⁶⁷ More recent economic analysis highlights additional costs to firms - given that tariffs may be applied to traded intermediate inputs such as automobile parts, with the increasing importance of value-chains, tariffs increase costs to firms who rely on imported intermediate inputs.⁶⁸

The exception to the standard economic case against tariffs is when a country is “large” enough to affect its international terms-of-trade, i.e., the price it pays on the world market for imports relative to the world price of its exports. In the case previously outlined, the world price of imported goods does not change with the imposition of tariffs as the importing country is too “small” to exercise any market power. However, if an importing country is large enough, the

⁶¹ See Mary Amiti, Stephen J. Redding, and David E. Weinstein, “The Impact of the 2018 Tariffs on Prices and Welfare,” *Journal of Economic Perspectives* 33, no.4 (Fall 2019): 187-210, 187-189.

⁶² See Pablo D. Fajgelbaum, Pinelopi L. Goldberg, Patrick J. Kennedy, and Amit K. Khandelwal, “The Return to Protectionism,” *Quarterly Journal of Economics* 135, no.1 (Feb. 2020): 1-55, 2-6.

⁶³ 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, (Washington DC: US Senate, June 8, 2018), 3.

⁶⁴ See James R. Markusen, James R. Melvin, William H. Kaempfer, and Keith A. Maskus, *International Trade: Theory and Evidence*, (New York, NY: McGraw Hill, 1995), 245-258.

⁶⁵ See *Id.*, at 246-249.

⁶⁶ See *Id.*, at 246-249.

⁶⁷ See *Id.*, 281-284.

⁶⁸ See Emily J. Blanchard, “Trade Wars in the GVC Era,” in Meredith A. Crowley (Ed.), *Trade War: The Clash of Economic Systems Endangering Global Prosperity* (London: CEPR Press, 2019), 57-63, 57.

world price of its imports will fall as the tariff is imposed.⁶⁹ In this case, national economic welfare may increase, as the deadweight losses borne by consumers are more than compensated for by additional tariff revenue. In other words, part of the cost of the tariff is now borne by exporting countries who face a lower world price for their exports, i.e., they suffer an international terms-of-trade loss.⁷⁰ However, this case only applies if we assume that the exporting country facing the increase in tariffs does not retaliate. If it does, the tariff “war” that arises leads to economic losses for both countries due to a terms-of-trade “prisoners’ dilemma”.⁷¹ To the extent that the trade war between the United States and China is representative of this case, both countries, including the United States as instigator of the trade war, have incurred economic losses.

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.^{72,73} 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.⁷⁴ 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.⁷⁵ Not surprisingly, there is an ongoing debate in the Biden administration over cutting these tariffs to reduce the current U.S. rate of inflation.⁷⁶ 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.⁷⁷

These studies have also found 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 terms-of-trade theory of trade agreements.⁷⁸ Over a longer time-period, it might be expected exporters would eventually cut

⁶⁹ See Bickerdike, *supra* note 3, at 529-530.

⁷⁰ See Markusen *et al.*, *supra* note 64, 254-256.

⁷¹ See Bagwell and Staiger, *supra* note 3, 216-217.

⁷² See Amiti *et al.*, *supra* note 61, at 199-201.

⁷³ See Fajgelbaum *et al.*, *supra* note 62, at 42-45.

⁷⁴ See *Id.*, at 42-45.

⁷⁵ See Amiti *et al.*, *supra* note 61, 199-201.

⁷⁶ See Megan Hogan and Yilin Wang, “To Fight Inflation, Cutting Tariffs on China is only the Start,” *Realtime Economic Issues Watch* (Washington DC: Peterson Institute for International Economics, June 3, 2022). <https://www.piie.com/blogs/realtime-economic-issues-watch/fight-inflation-cutting-tariffs-china-only-start>.

⁷⁷ See Gary C. Hufbauer, Megan Hogan, and Yilin Wang, “For Inflation Relief, the United States Should Look to Trade Liberalization,” *Policy Brief 22-4* ((Washington DC: Peterson Institute for International Economics, March 2022), 5.

⁷⁸ See Christian Broda, Nuno Limao, and David E. Weinstein, “Optimal Tariffs and Market Power,” *American Economic Review* 98, no.5 (Dec. 2008): 2032-2065, 2032-2034; see also Kyle Bagwell and Robert W. Staiger, “What Do Trade Negotiators Negotiate About? Empirical Evidence from the World Trade Organization?” *American Economic Review* 101, no.4 (Jun. 2011): 1238-1273, 1238-1241.

before-tariff prices, especially if there was resolution of exporter uncertainty about how long the tariffs will remain in place.⁷⁹ 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.⁸⁰

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.⁸¹ 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,⁸² with a significant amount of trade also being diverted to other exporting countries such as Brazil.⁸³ 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 2020.⁸⁴

In summary, the evidence clearly shows the incidence of import tariffs implemented in 2018 was entirely borne by U.S. consumers, any terms-of-trade effects on the import side being insignificant. Also, if there had been no retaliation by China and other countries, there would have been a modest U.S. real income gain of \$0.5 billion in 2018 due to terms-of-trade effects on the export side. In other words, the logic of “power-based” bargaining only ever had the potential to work if China and other countries had not adopted a trigger strategy in response to the increase in U.S. tariffs.

The overall conclusion is the U.S.-China trade war has come at a cost to U.S. consumers, taxpayers, and exporters. In addition, under USCTA, neither country has committed to returning tariffs back to their pre-2018 bound levels. For all intents and purposes, the United States and China have suspended their GATT/WTO obligations under GATT Article XXIII. This has

⁷⁹ See Robert W. Staiger, *A World Trading System for the Twenty-First Century* (Oct. 2021), 51-57. https://cpb-us-e1.wpmucdn.com/sites.dartmouth.edu/dist/b/2093/files/2021/10/Ohlin_Book_RWS_Final_Revision_10142021.pdf.

⁸⁰ See Mary Amiti, Stephen J. Redding, and David E. Weinstein, “Who’s Paying for the U.S. Tariffs? A Longer-Term Perspective,” *AEA Papers and Proceedings* 110 (May 2020): 541-546, 541.

⁸¹ 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,” *Applied Economic Perspectives and Policy* 43, no.2 (Jun. 2021): 619-640, 626-629.

⁸² See Michael K. Adjemian, Shawn Arita, Vince Breneman, Robert Johansson, and Ryan Williams, “Tariff Retaliation Weakened the U.S. Soybean Basis,” *Choices* 34, no.1 (2019), 1.

⁸³ See Colin A. Carter and Sandro Steinbach, “The Impact of Retaliatory Tariffs on Agricultural and Food Trade,” NBER Working Paper 27147 (Cambridge, MA: National Bureau of Economic Research, May 2020), 12-13.

⁸⁴ See Joseph W. Glauber, “Is it Time for the United States to Again Show Leadership at the WTO?” (Washington DC: American Enterprise Institute, Center for Strategic and International Studies, September 16, 2020), <https://www.csis.org/analysis/it-time-united-states-again-show-leadership-wto>.

significant long-run implications for the “rules-based” multilateral trading system.⁸⁵ 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.⁸⁶ 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.⁸⁷

C. “Power-Based” Bargaining: What is Missing?

Despite the documented disruption and economic damage due to the U.S.-China trade war, why has the United States put the multilateral trading system at risk through “power-based” bargaining? Pronouncements by the previous administration on the USCTA indicate a prime goal of the agreement was to reduce the trade deficit with China⁸⁸, which squares with the rationale for U.S. targeting of its “bargaining” tariffs.⁸⁹ The extensive focus on China’s progress in meeting its import commitments under USCTA also lead to a conclusion the agreement was essentially about reducing the bilateral trade deficit with China.⁹⁰

To be fair, while the official text of USCTA is remarkably short for a typical trade agreement, it does focus on more than expansion of trade, other chapters covering protection of intellectual property, technology transfer, non-tariff barriers to agricultural trade, financial services, exchange rates, and dispute resolution.⁹¹ 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.

Imposition of tariffs by the United States reflects its and other countries’ concerns about the Chinese economic model that has evolved since 2001.⁹² Key to this is that, while Chinese firms compete with one another, they may be subsidized relative to their foreign competition. First, SOEs in some industries face soft budget constraints.⁹³ Second, some Chinese firms are

⁸⁵ See Mattoo and Staiger, *supra* note 48, 570-573.

⁸⁶ See Giovanni Maggi, “The Role of Multilateral Institutions in International Trade Cooperation,” *American Economic Review* 89, no.1 (Mar. 1999): 190-214, 209-210

⁸⁷ See Mattoo and Staiger, *supra* note 48, 573-576.

⁸⁸ See Chad P. Bown, C.P. 2021. “The US-China Trade War and Phase One Agreement” *Journal of Policy Modeling* 43, no.4 (Jul-Aug. 2021): 805-843, 830.

⁸⁹ See Mattoo and Staiger, *supra* note 48, at 573-576.

⁹⁰ See Hillman, *supra* note 63, at 3.

⁹¹ See Office of the United States Trade Representative (USTR), *supra* note 51.

⁹² See Mark Wu, “The ‘China, Inc.’ Challenge to Global Trade Governance,” *Harvard International Law Journal* 57, no.2 (Spring 2016): 261-324, 269-284; see also Mark Wu, M. 2019. “China’s Rise and the Growing Doubts over Trade Multilateralism,” in Meredith A. Crowley (Ed.), *Trade War: The Clash of Economic Systems Endangering Global Prosperity* (London: CEPR Press, 2019), 101-110, 101-103; see also Chad P. Bown and Jennifer A. Hillman, “WTO’ing a Resolution to the China Subsidy Problem,” *Journal of International Economic Law* 22, no.4 (Dec. 2019): 557-558, 562-564.

⁹³ See Nicholas R. Lardy, *The State Strikes Back: The End of Economic Reform in China?* (Washington DC: Peterson Institute for International Economics, 2019), 4.

influenced either directly or indirectly by the Chinese Communist Party (CCP). This phenomenon, denoted as “China Inc.,” is one where intervention in the Chinese economy does not always flow through the state, the CCP functioning as a separate actor.⁹⁴ In combination with an emphasis on market forces, the Party-state can influence economic outcomes through: controlling key sectors of the Chinese economy (aerospace, aviation, energy, transport, communications etc.); directing financial resources via large Chinese banks; guiding and coordinating government agencies and firms via Party entities such as the Central Financial and Economic Affairs Commission; facilitating coordination through informal networks in specific sectors; setting performance metrics and controlling hiring within government, SOEs, banks etc.; and, developing formal and informal linkages between the Party and private firms. The net result of “China Inc.” is subsidies are often targeted through informal channels and not directly via the state.⁹⁵ Third, use of export taxes, and the discriminatory rebate of value-added taxes on exports act as implicit export subsidies, e.g., export taxes on raw materials drive down their domestic price(s), providing a competitive advantage to downstream users (Garred, 2018).⁹⁶

V. WHAT CAN BE DONE ABOUT CHINA’S ECONOMIC MODEL?

Given U.S. concerns about China’s economic model, and how it feels constrained by the WTO from using what it regards as legitimate trade remedies against China, it is surprising the issue is totally invisible in the USCTA. Essentially, “power-based” bargaining in this respect has been a failure, even though it brought China to the bilateral bargaining table. Are there any alternatives?

Hillman has argued the United States should form a coalition with other WTO members to put together a comprehensive case against China.⁹⁷ In her Congressional testimony, she lays out in detail, the legal reasoning for filing both *violation* and *non-violation* cases against China on the grounds that its trade and other measures “nullify or impair” the benefits of the U.S. and other WTO members. To understand the potential role either a violation and/or a non-violation claim could play in addressing the problem of “China Inc.,” it is important to start with the economic logic of the GATT/WTO.⁹⁸

A. The Economic Logic of GATT/WTO

Assume a world where two countries produce and consume two final products, each country having a comparative advantage in producing one of the goods, both countries being large enough to influence their terms-of-trade through exploitation of their market power, i.e., as noted earlier, if they implement a tariff the world price of their imports will fall relative to the world price of their exports. With appropriate assumptions, the economic welfare of each country can be defined as a function of these tariffs, the terms-of-trade gain to each country,

⁹⁴ See Wu, *supra* note 92, at 282-284.

⁹⁵ See *Id.*, at 282-284.

⁹⁶ Jason Garred, “The Persistence of Trade Policy in China after WTO Accession,” *Journal of International Economics* 114, no.3 (Sep. 2018): 130-142, 130-131.

⁹⁷ See Hillman, *supra* note 63, at 2.

⁹⁸ Benjamin Zissimos, “The GATT and Gradualism,” *Journal of International Economics* 71, no.2 (Apr. 2007): 410-433.

measured in terms of additional tariff revenue, outweighing any deadweight loss from higher domestic prices due to the tariff. In the absence of a trade agreement, neither country can change their tariff strategy and be better off. 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 beneficial for 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.⁹⁹ In other words, if terms-of-trade effects have been removed from any country's objective function, it will set tariffs to satisfy domestic political objectives alone.¹⁰⁰ These tariffs would be either zero if a country seeks to maximize its national income through free trade, or they would be positive to satisfy domestic political constraints, but importantly, they are lower than those at the non-cooperative equilibrium. Therefore, if countries enter into a trade agreement, they seek mutual reductions in tariffs generating an increase in domestic and global economic welfare.

The economic theory of trade agreements as outlined has been criticized on the grounds that trade practitioners never actually mention the concept of terms-of-trade in trade negotiations.¹⁰¹ However, this ignores the relationship between import demand and import prices.¹⁰² 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.¹⁰³ 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.

Market access should be seen in the context of what is termed *first-difference* (marginal) reciprocity where trade negotiations focus on balancing concessions on tariffs given an initial set of conditions. A dynamic process can be described where negotiators trade off increased access to their own markets through tariff cuts in exchange for access to export markets, i.e., the concerns of those lobbying for the import-competing sectors are balanced by those lobbying for the export-competing sectors.¹⁰⁴ In other words, negotiations in the GATT/WTO have proceeded on the basis that there will be a balance of trade concessions between member countries, measured in terms of increased market access, but in the final deal, each member country continues to protect a set of politically-sensitive sectors that will likely differ across countries.¹⁰⁵

⁹⁹ See Bagwell and Staiger, *supra* note 3, at 217.

¹⁰⁰ See Bagwell and Staiger, *supra* note 3, at 224.

¹⁰¹ See Donald H. Regan, "Explaining Trade Agreements: The Standard Practitioners' Story and the Standard Model," *World Trade Review* 14, no.3 (Jul. 2015):391-417, 391-395.

¹⁰² See Staiger, *supra* note 79, at 51-57.

¹⁰³ See *Id.*, at 51-57.

¹⁰⁴ See Richard E. Baldwin, "Multilateralizing Regionalism: Spaghetti Bowls as Building Blocs on the Path to Free Trade", *World Economy* 29, no.11 (Nov. 2006): 1451-1518, 1459-1466.

¹⁰⁵ See "Who's Tit and Who's Tat?" *The Economist* (July 24, 2018).

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 repeated game, the punishment for not adhering to a trade agreement is reversion to the non-cooperative equilibrium of high tariffs, i.e., what is termed a trigger strategy.¹⁰⁶ 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 by a member country.¹⁰⁷

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 the outcome of a violation complaint, the other country can withdraw an equivalent amount of market access. 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 non-cooperative tariffs.¹⁰⁸ 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.¹⁰⁹ In other words, the objective of GATT/WTO rules is to ensure 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 non-cooperative 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 non-cooperative equilibrium tariff, it is considered “abusive”, the other country setting the higher retaliatory tariff in all future periods.¹¹⁰ 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 non-cooperative tariffs by both countries.

The recent history of tariffs imposed by the United States and China on each other’s imports are summarized in Figure 1: prior to 2018, U.S.-China trade-weighted tariff rates toward each other averaged 3.1 and 8 percent respectively.¹¹¹ By the end of 2018, trade-weighted average U.S. 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

¹⁰⁶ Avinash Dixit, “Strategic Aspects of Trade Policy,” in Truman F. Bewley (Ed.), *Advances in Economic Theory: Fifth World Congress* (Cambridge: Cambridge University Press, 1987), 329-359, 329-335.

¹⁰⁷ Robert W. Staiger, “International Rules and Institutions for Trade Policy,” in Gene Grossman, and Kenneth Rogoff (Eds.), *Handbook of International Economics Volume 3* (Amsterdam: Elsevier, North Holland, 1995), 1495-1551, 1519-1528.

¹⁰⁸ See Jackson, *supra* note, at 94.

¹⁰⁹ See Zissimos, *supra* note 98, at 417.

¹¹⁰ See *Id.*, at 417.

¹¹¹ See Bown, *supra* note 57, 812-818.

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).¹¹² 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-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 1930.¹¹³

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).¹¹⁴ Third, even though China filed a complaint to 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 non-cooperative equilibrium. Finally, notwithstanding the USCTA, tariffs implemented by both countries remain in place.¹¹⁵

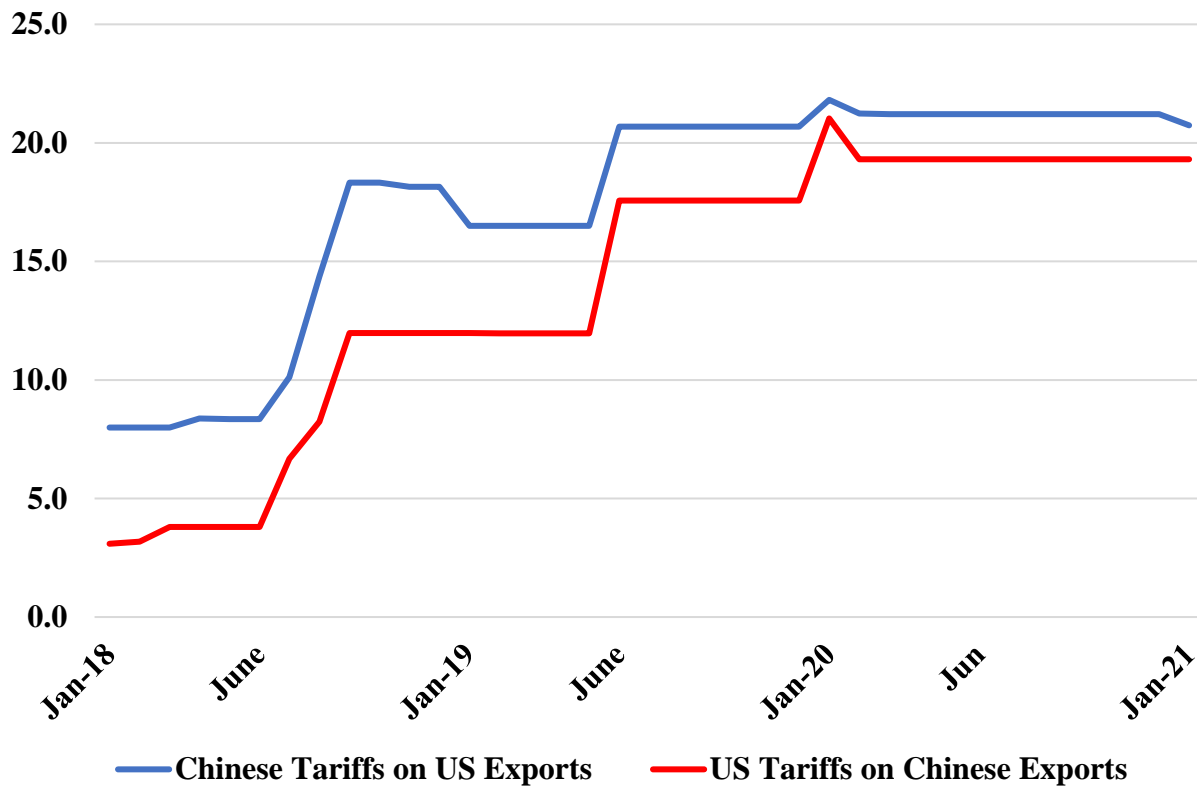
¹¹² See *Id.*, at 812-818

¹¹³ See Chad P. Bown, and Douglas A. Irwin, 2018. “What Might a Trump Withdrawal from the World Trade Organization Mean for US Tariffs?” *Policy Brief* 18-23 (Washington DC: Peterson Institute for International Economics, 2018), 2-8.

¹¹⁴ See World Trade Organization (WTO), *United States-Tariff Measures on Certain Goods from China*. Report of the Panel, WT/DSS543/R (Geneva: WTO, November 26, 2020). https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds543_e.htm.

¹¹⁵ See Bown, *supra* note 57, at 828.

Figure 1: U.S.-China Tariffs Against Each Other 2018-21



Notes: Trade-weighted average tariffs computed from product-level (6-digit Harmonized System) tariff and trade data, weighted by exporting country's exports to the world in 2017.¹¹⁶

¹¹⁶ See Bown, *supra* note 57, at 814. Tariff data sourced from Chad P. Bown, "US-China Trade War Tariffs: An Up-to-Date Chart," *PIIE Charts* (Washington DC: Peterson Institute for International Economics, March 16, 2021).

B. A Violation Complaint

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.¹¹⁷ 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.¹¹⁸

While China has adopted a variety of domestic policies, the focus here is on subsidies. In her Congressional testimony, Hillman argues 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.¹¹⁹ From the standpoint of economic theory, 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).¹²⁰ They are also a first-best instrument by the targeting principle, i.e., the market failure should be directly targeted at source.¹²¹ 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.¹²²

Notwithstanding economic theory, 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 (CVD) 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* 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.¹²³ Finally, the Uruguay Round of GATT led to the WTO Agreement on Subsidies and Countervailing Measures (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).

¹¹⁷ See Hillman, *supra* note 63, at 3.

¹¹⁸ See Staiger, *supra* note 79, at 126-127.

¹¹⁹ See Hillman, *supra* note 63, at 6-7.

¹²⁰ See Bown and Hillman, *supra* note 92, at 560.

¹²¹ See Jagdish Bhagwati and V.K. Ramaswami, "Domestic Distortions, Tariffs and the Theory of Optimum Subsidy," *Journal of Political Economy* 71, no.1 (Feb. 1963): 44-50, 44-46; see also Harry G. Johnson, "Optimal Trade Intervention in the Presence of Domestic Distortions," in Richard E. Caves, Harry G. Johnson, and Peter B. Kenen (Eds.), *Trade, Growth, and the Balance of Payments: Essays in Honor of Gottfried Haberler* (Chicago, IL: Rand McNally and Company, 1965), 3-34, 3-14.

¹²² See Kyle Bagwell, and Robert W. Staiger, "Will International Rules on Subsidies Disrupt the World Trading System?" *American Economic Review* 96, no.3 (Jun. 2006): 877-895, 877.

¹²³ See Bown and Hillman, *supra* note 92, at 560-561.

Analytically, it has been shown the SCM is perhaps too restrictive relative to the first-best rationale for subsidies, providing an incentive for governments to use more indirect and non-transparent second-best policies.¹²⁴ Under the original GATT rules, if a country had a set of domestic policy instruments at its disposal, e.g., subsidies and taxes, and there was a successful non-violation claim, as long as it made a domestic policy adjustment restoring market access, it was under no obligation to remove the subsidy. In contrast under the SCM, if a subsidy is successfully challenged, it must be removed for there to be compliance.¹²⁵ The corollary of this is that the willingness of countries to make market access commitments will be undermined if their use of subsidies is then subject to ASCM challenge. Hence the temptation to use other non-transparent domestic policies that substitute for subsidies.

Detailed assessment of why the SCM is practically ineffective has also been provided, pointing out both definitional and evidentiary problems.¹²⁶ First, China challenged U.S.-use of CVDs 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.¹²⁷ 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 ASCM 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.^{128, 129}

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

C. A Non-Violation Complaint

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.^{130,131} 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

¹²⁴ See Bagwell and Staiger, *supra* note 122, at 885-887.

¹²⁵ See *Id.*, at 888-889.

¹²⁶ See Bown and Hillman, *supra* note 92, at 567-570.

¹²⁷ World Trade Organization (WTO), *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, Report of the Appellate Board, WT/DS379/AB/R (Geneva: WTO, March 11, 2011); see also Dukgeun Ahn, “Why Reform is Needed: WTO ‘Public Body’ Jurisprudence,” *Global Policy* 12, no.3 (Apr. 2021) for a discussion of this ruling by the AB.

¹²⁸ See Wu, *supra* note 92, at 107.

¹²⁹ See Chad P. Bown, “Trump Ended WTO Dispute Settlement. Trade Remedies are Needed to Fix It,” *World Trade Review* 21, no.3 (Jul. 2022): 312-329, 323-324 for a discussion of writing more legal precision on subsidies.

¹³⁰ See Hillman, *supra* note 63, at 10-11.

¹³¹ See Staiger, *supra* note 79, at 130-134.

explicitly in violation of specific WTO obligations such as SCM.¹³² 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.¹³³ Importantly, the non-violation clause plays an important role in facilitating the “shallow” approach of GATT/WTO to international integration.^{134,135}

As noted earlier, while concerns have been expressed by economists about the efficacy of current GATT/WTO rules on subsidies,¹³⁶ 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.¹³⁷ 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.¹³⁸ 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...”^{139 140}

A way of thinking about non-violation complaints is to recognize that market access effects can arise from a broad range of domestic policies that are either unregulated or only partially regulated by existing GATT/WTO rules, e.g., environmental standards, and competition policy.^{141,142} In principle, a non-violation complaint has the potential to resolve the market access issue. Formally, an importing government makes both trade and regulatory policy choices,

¹³² See Robert W. Staiger, and Alan O. Sykes, “How Important Can the Non-Violation Clause Be for the GATT/WTO?” *American Economic Journal: Microeconomics* 9, no.2 (May 2017): 149-187, 149.

¹³³ *Supra* Staiger, *supra* note 79, at 117.

¹³⁴ See Kyle Bagwell, and Robert W. Staiger, “Domestic Policies, National Sovereignty, and International Economic Institutions,” *Quarterly Journal of Economics* 116, no.2 (May 2001): 519-562, 523-525.

¹³⁵ See Robert W. Staiger, and Alan O. Sykes, “International Trade, National Treatment, and Domestic Regulation,” *Journal of Legal Studies* 40, no.1 (Jan. 2011): 149-203, 190-194.

¹³⁶ See Bagwell and Staiger, *supra* note 122, at 877-879.

¹³⁷ See Alan O. Sykes, “The Economics of WTO Rules on Subsidies and Countervailing Measures,” John M. Olin Law & Economics Working Paper No. 186 (Chicago, IL: University of Chicago Law School, May 2003), 17-18.

¹³⁸ See Staiger, *supra* note 79, at 132-133.

¹³⁹ See Hillman, *supra* note 63, at 13.

¹⁴⁰ Interestingly Wu, *supra* note 92, at 109, 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.

¹⁴¹ See Robert W. Staiger, and Alan O. Sykes, “Non-Violations,” *Journal of International Trade Law* 16, no.4 (Dec. 2013): 741-775, 757-758.

¹⁴² See Bagwell and Staiger, *supra* note 134, at 544-554, for a discussion of how this would work in the context of environmental regulation.

where an *ex-ante* contract rules out protectionist trade policy, except under special circumstances, but no such contract is available to cover regulatory policy. Interpretation by the dispute settlement body (DSB) of any policy choice is assumed “noisy”, and filing a complaint is costly.¹⁴³ If the importing country chooses protection, a violation complaint is filed by the exporting country, the importing country complying with any ruling against it. If the importing country chooses regulation, the exporting country can file a non-violation complaint, but if ruled against, the importing country is under no obligation to change its policy. Instead, it can either comply with the ruling or pay compensation to the exporting country. The amount of compensation received by the exporting country is less than what is actually paid by the importing country due to the deadweight losses of say tariff retaliation.¹⁴⁴

An exporting country will file a claim based on expected benefits, the key parameters being the probability of success, benefits of inducing compliance in a violation claim, level of compensation in a non-violation claim, and costs of litigation. While a successful violation claim is ranked higher by an exporting country due to compliance by the importing country, non-violation is the only viable claim available to the exporting country against importing country regulation. Without the potential for non-violation claims, an importing country could influence its terms-of-trade with impunity, as well as avoid a violation claim through use of trade policy. In the language of game theory, the potential for non-violation claims serves a function off-equilibrium by deterring the importing country from selecting regulation.^{145,146}

While non-violation claims under GATT/WTO have been rare,¹⁴⁷ 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.¹⁴⁸ 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,¹⁴⁹ the non-violation clause gives China the flexibility to augment the commitments it made when acceding to the WTO, i.e., China could re-establish reciprocity without necessarily reforming its own economic system.

Arguably, China could well see it in its own interests to facilitate such rebalancing.¹⁵⁰ 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

¹⁴³ See Staiger and Sykes, *supra* note 132, at 156-163.

¹⁴⁴ See Giovanni Maggi and Robert W. Staiger, “Trade Disputes and Settlement,” *International Economic Review* 59, no.1 (Feb 2018): 19-50, 20.

¹⁴⁵ See Staiger and Sykes, *supra* note 141, at 760-761.

¹⁴⁶ See Staiger and Sykes, *supra* note 132, 170-171.

¹⁴⁷ See Staiger and Sykes, *supra* note 141, at 743-744.

¹⁴⁸ See Staiger, *supra* note 79, at 132-133.

¹⁴⁹ See Hillman, *supra* note 63, at 13

¹⁵⁰ See Staiger, *supra* note 79, at 132.

the GATT in the 1960s and 1970s.^{151,152} 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, even if there are legitimate concerns about their transparency. However, the argument here is that making such commitments relies on the multilateral system as opposed to bilateral bargaining, 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 re-commits to reciprocity if ruled against.

VI. CONCLUSION

The motivation for this article is the argument U.S. trade policy has shifted from a “rules-based” to a “power-based” approach, with a focus on the use of “bargaining” tariffs targeted at countries such as China. Superficially this strategy appears to have worked following implementation of the USCTA in early 2020. However, this is misleading: the United States adopted a sub-optimal strategy in switching to “power-based” bargaining. Although it resulted in the USCTA, there are multiple non-trivial *caveats*: China has credibly punished U.S. “bargaining” tariffs with its own retaliatory tariffs, negatively affecting U.S. farmers and taxpayers; U.S. tariffs against China, remain above their bound levels with the likelihood of continued deadweight losses to the U.S. economy; the longstanding U.S. trade deficit has not been solved through “bargaining” tariffs against China; no progress has been made on disciplining China’s use of subsidies either bilaterally or multilaterally; and the continued functioning of the multilateral trading system has been placed at risk by U.S. actions. Therefore, in coalition with other members of the WTO, the United States should file both violation and non-violation complaints against China.

Of course, this recommendation requires a functioning dispute resolution mechanism. As of December 10, 2019, the WTO’s Appellate Body ceased to function after the terms of two of the remaining Appellate Body members ended, the Appellate Body requiring at least three members to hear appeals.¹⁵³ While the current legal stalemate over the future of the Appellate Body should be seen as a symptom rather than the cause of the breakdown in the dispute settlement process, the United States’ dissatisfaction with the Appellate Body is certainly a function of how it believes it has been constrained by the latter in using trade remedies against China.¹⁵⁴ However, as noted by Professor Chow, crippling of the Appellate Body by the United States has significantly undermined the WTO, countries trade obligations no longer being enforceable. This brings with it the attendant risk that international trading relations could return to the “law of the jungle” observed during the inter-war years, with the widespread application of “vigilante justice” outside the WTO’s rules-based system.¹⁵⁵

¹⁵¹ See Maciej Kostecki, “Hungary and GATT,” *Journal of World Trade Law* 8, no.4 (Jul-Aug. 1974): 401-419.

¹⁵² See Leah Haus, “The East European Countries and GATT: The Role of Realism, Mercantilism, and Regime Theory in Explaining East-West Trade Negotiations,” *International Organization* 45, no.2 (Spring 1991): 163-182.

¹⁵³ See Pauwelyn, *supra* note 50, at 297-300.

¹⁵⁴ See Chad Bown and Soumaya Keynes, “Why Trump Shot the Sheriffs: The End of WTO Dispute Settlement 1.0.,” *Journal of Policy Modeling* 42, no.4 (Jul-Aug. 2020): 799-819, 799-800.

¹⁵⁵ See Staiger, *supra* note 79, at 33-34, and 115.