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China Inc. in the WTO Dock

Tales from a System under Fire

Paul Blustein



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CIGI Masthead

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About the Author

Paul Blustein is a CIGI senior fellow. An award-winning journalist and author, he has written extensively about international economics, trade and financial crises. Prior to joining CIGI in 2010, Paul was a staff writer for *The Washington Post* and *The Wall Street Journal*, and journalist-in-residence at The Brookings Institution.

A native of Washington DC, Paul attended the University of Wisconsin (B.A., history), before heading to Oxford University on a Rhodes Scholarship, graduating with an M.A. in philosophy, politics and economics in 1975.

Paul is currently working on a book about China and the global trading system, which will be published by CIGI in early 2019. His previous books include *The Chastening: Inside the Crisis That Rocked the Global Financial System and Humbled the IMF* (2001); *And the Money Kept Rolling In (and Out): Wall Street, the IMF, and the Bankrupting of Argentina* (2005); *Misadventures of the Most Favored Nations: Clashing Egos, Inflated Ambitions, and the Great Shambles of the World Trade System* (2009); *Off Balance: The Travails of Institutions That Govern the Global Financial System* (2013); and *Laid Low: Inside the Crisis That Overwhelmed Europe and the IMF* (2016).

About the Global Economy Program

Addressing limitations in the ways nations tackle shared economic challenges, the Global Economy Program at CIGI strives to inform and guide policy debates through world-leading research and sustained stakeholder engagement.

With experts from academia, national agencies, international institutions and the private sector, the Global Economy Program supports research in the following areas: management of severe sovereign debt crises; central banking and international financial regulation; China's role in the global economy; governance and policies of the Bretton Woods institutions; the Group of Twenty; global, plurilateral and regional trade agreements; and financing sustainable development. Each year, the Global Economy Program hosts, co-hosts and participates in many events worldwide, working with trusted international partners, which allows the program to disseminate policy recommendations to an international audience of policy makers.

Through its research, collaboration and publications, the Global Economy Program informs decision makers, fosters dialogue and debate on policy-relevant ideas and strengthens multilateral responses to the most pressing international governance issues.

About the International Law Research Program

The International Law Research Program (ILRP) at CIGI is an integrated multidisciplinary research program that provides leading academics, government and private sector legal experts, as well as students from Canada and abroad, with the opportunity to contribute to advancements in international law.

The ILRP strives to be the world's leading international law research program, with recognized impact on how international law is brought to bear on significant global issues. The program's mission is to connect knowledge, policy and practice to build the international law framework — the globalized rule of law — to support international governance of the future. Its founding belief is that better international governance, including a strengthened international law framework, can improve the lives of people everywhere, increase prosperity, ensure global sustainability, address inequality, safeguard human rights and promote a more secure world.

The ILRP focuses on the areas of international law that are most important to global innovation, prosperity and sustainability: international economic law, international intellectual property law and international environmental law. In its research, the ILRP is attentive to the emerging interactions among international and transnational law, Indigenous law and constitutional law.

Executive Summary

For all of US President Donald Trump's misconceptions about trade, many economists share his administration's concern about the World Trade Organization's (WTO's) ineffectiveness in dealing with China's economic policies. Trade experts across the political spectrum agree that the role of the Communist party-state in the Chinese economy has become so pervasive and opaque that key elements are beyond the scope of WTO rules. But the trade body is by no means impotent in this regard. Many countries have obtained redress by bringing complaints against China to WTO tribunals, and Beijing generally complies when it loses.

To shed light on this issue, this paper examines two WTO cases involving China in detail — one a Chinese loss, the other a Chinese victory. The purpose is to show how the system works, and highlight its strengths and weaknesses, especially with regard to China. The second case is a landmark, and is especially troubling because Beijing won on a crucial point — where does China's truly private sector end and the party-state begin? This case also illuminates another worrisome problem facing the WTO, namely US actions that threaten to undermine the trade body's dispute settlement system.

Taken together, these two cases illustrate why the WTO should be viewed as well-suited in many respects to fulfilling its mission — and well worth preserving — but far from perfect regarding the quandaries posed by China, and sorely in need of other improvements as well.

Introduction

For those who believe in strong multilateral institutions to manage global problems, it would be hard to imagine a more disheartening message than the one delivered on September 18, 2017, by Robert Lighthizer, the United States Trade Representative (USTR). Speaking before a Washington audience, Lighthizer disparaged the WTO, depicting it as ineffectual on an issue crucial to its mission — China's economic juggernaut.

The WTO, Lighthizer (2017) contended, “is not equipped to deal” with the policies that China has adopted to foster its industrial advancement. “The sheer scale of [China's] coordinated efforts to develop [its] economy, to subsidize, to create national champions, to force technology transfer, and to distort markets in China and throughout the world is a threat to the world trading system that is unprecedented,” he said. “The WTO and its predecessor, the General Agreement on Tariffs and Trade, were not designed to successfully manage mercantilism on this scale. We must find other ways to defend our companies, workers, farmers, and indeed our economic system.”

Lighthizer's comments were a grave omen for the WTO, which stands out among multilateral institutions for its widely accepted and enforceable rules. Of all the trade agreements menaced by the Trump administration, none looms larger. Based in Geneva, the 164-member WTO is the current embodiment of the system established after World War II to prevent a reversion to the protectionist horrors of the 1930s. WTO rules keep a lid on countries' import barriers, and members take their disputes to WTO tribunals for adjudication rather than engage in tit-for-tat trade wars. In addition, the WTO is the guardian of the “most-favoured-nation” principle, under which member countries pledge to treat each other's products on a nondiscriminatory basis — a valuable bulwark against the formation of hostile trade blocs.

For all the WTO's virtues, the concern expressed by Lighthizer about its handling of China-related issues is legitimate. China's policies are bedeviling the trade body in ways that were unforeseen at the time Beijing joined and are increasingly glaring now — all the more given the immensity of the Chinese economy. But the WTO's impotence in dealing with China should not be exaggerated. In numerous instances, countries have brought complaints against Beijing to the trade body's tribunals and gotten satisfaction.

To elucidate this subject, this paper will examine two WTO disputes involving China in detail.¹ The

¹ Sources for this paper, which will be incorporated in a forthcoming book, include scores of people interviewed in Beijing, Brussels, Geneva, Tokyo and Washington, as well as a review of thousands of pages of documents in the public record. Nearly all interviews were conducted on a “deep background” basis, the purpose being to elicit the maximum amount of candour. To the extent sources of information can be identified, footnotes are provided, but full attribution would be impossible without compromising interviewees' confidentiality.

first case involves allegations that Beijing took unfair competitive advantage of its control over rare earths — minerals with names such as cerium, neodymium, praseodymium and samarium — which are crucial in the manufacturing of high-tech products, including hybrid cars, smart phones, guided missiles, low-energy light bulbs and camera lenses.

The second case involves a clash between China and the United States over whether Beijing was subsidizing certain products, such as tires for tractors and construction vehicles, that Chinese companies were exporting to the US market. This case is considered a landmark because WTO jurists confronted a central question about the Chinese economy: where is the line between private enterprise and the Communist party-state?

Case number one was a Chinese defeat; case number two was a Chinese victory. The purpose of chronicling them is not to belabour the obvious point that “you win some, you lose some” at the WTO, just as in tribunals elsewhere. Rather, it is to show how the system functions, and where its strengths and weaknesses lie — especially with regard to China.

An in-depth examination of these cases also provides insight into the importance of preserving the WTO, its defects notwithstanding. But before delving into the cases, it is necessary to put them in historical context, by reviewing the upheaval that China has perpetrated on the trading system and how the system has responded.

Welcome to the Club

China joined the WTO in 2001, integrating the world’s most populous nation into the global economy during a period when the country was still shedding vestiges of Maoist totalitarianism. The ramifications proved positive in major respects.

Gaining membership in the WTO required China to undergo years of fractious negotiations, with US trade officials serving as Beijing’s chief interlocutors and tormentors. The Americans demanded measures to reform the state-dominated Chinese economy and open the nation’s markets in ways that exceeded the requirements imposed on other

countries. For example, China had to promise that it would reduce its tariffs on manufactured goods to an average of about nine percent by 2005 — less than one-third of the comparable figures for Argentina, Brazil, India and Indonesia.² The main reason Chinese officials accepted such onerous conditions was that WTO membership conferred enormous potential benefits, in particular protection against the arbitrary imposition of sanctions on Chinese exports.

Transformative results ensued, as thousands of Chinese laws and regulations were changed and scrapped to conform with the commitments Beijing had made. In response to the much greater openness and predictability of the market, foreign companies’ China-based operations expanded dramatically. The economy, which had already grown so robustly during the 1980s and 1990s as to lift hundreds of millions of Chinese out of poverty, surged forward on an even steeper upward trajectory. During the first decade after entry into the WTO, China’s GDP nearly tripled in real (inflation-adjusted) terms, while exports quintupled. Consumers the world over saved tidy sums by buying “Made in China” products, and producers the world over — American and European airplane manufacturers, Brazilian and Canadian farmers, Japanese and German machinery makers — cranked up their own exports to satisfy booming Chinese demand. Economic liberalization and the adoption of reforms promoting the rule of law raised expectations in the early 2000s that China was on a gradual path toward true free enterprise — if not fully unbridled, then at least a form similar to that in, say, South Korea or Taiwan.

So much for the upside. The impact of Chinese imports on American blue-collar communities, a phenomenon that economists have called “the China shock” (Autor, Dorn and Hanson 2016), helped fuel a backlash against globalization that, in turn, helped propel Trump to the presidency. Moreover, by the end of China’s first decade in the WTO, free marketeers’ optimism about the nation’s economic course was dissipating. The leadership in Beijing was guiding the country in a new direction, variously dubbed “state capitalism,” “techno-nationalism” and “China Inc.”

2 The figure refers to “bound” tariffs, meaning the maximum China and the other countries are allowed to impose under their WTO commitments. “Applied” tariffs — the duties actually imposed by law — are usually lower.

Although China's private sector is vibrant and flourishing, accounting for an estimated two-thirds of economic output (Lardy 2014), intervention by the government and Communist Party has become far more pervasive. Institutions established or beefed up after WTO entry give Beijing tighter and more efficient control over the management of state-owned enterprises (SOEs) and banks, the setting of prices for key commodities and inputs, allocation of subsidies, enforcement of regulations and approval of investments.³ A series of industrial policy initiatives rolled out over the years bestow advantages on indigenous firms favoured by the party-state (the "national champions" to which Lighthizer referred).⁴ Thanks to Party control over matters such as the selection of top executives at SOEs, Beijing's edicts are difficult, if not impossible, to resist.

As a result, foreign firms that had once been welcomed with open arms fume about falling victim to a bewildering array of obstacles and directives aimed at promoting and protecting their Chinese competitors. High on the list of grievances are bullying tactics effectively forcing the handover of proprietary technology, or the purchase of inputs from domestic suppliers, as the price of access to the vast Chinese market.

In theory, the WTO provides the means to address such problems. Sometimes, just levelling threats of a WTO case can bring about changes in Chinese trade practices;⁵ Beijing dislikes the embarrassment of being branded a rule-breaker by the trade body. And when China does lose a WTO case — as it has on issues ranging from imported auto parts to semiconductor tax rebates to foreign movie distribution — it has a commendable record of complying. By comparison, the United States,

which has ignored or skirted negative rulings in several cases, is an international scofflaw.

But whether those outcomes provide adequate remedies for the challenge China poses to the trading system is a matter of debate that has grown particularly heated in recent months. Lighthizer's comments show where the Trump administration stands, and for all the president's misconceptions about trade, he and his acolytes are by no means alone in this regard. Trade experts across a broad swath of the political spectrum fret that China's system has become so opaque and uniquely structured that many of its key elements are beyond the scope of WTO rules and bedrock principles.⁶

Informing this debate is the reason for this paper's detailed perusal of two WTO disputes. Case number two involves exactly the kind of Chinese practices that are difficult for WTO rules to cover. Partly because of its legal importance, this case shall be chronicled at greater length in this paper than the rare earths case. The tale of case two also illuminates controversies about the WTO's dispute settlement system and US actions that threaten to undermine it — another profoundly worrisome problem facing the trade body.

In the mantra of WTO enthusiasts, dispute settlement is the trade body's "crown jewel." Just as governments have courts to resolve conflicts and interpret laws passed by their legislatures, the WTO's tribunals render judgment as to whether one nation or another is violating basic tenets such as the most-favoured-nation principle, or is failing to adhere to commitments in WTO agreements. These judgments have teeth; although a country found guilty of violations can exercise its sovereign right to refuse alterations in its laws, it may face economic punishment, usually in the form of tariffs levied on its products by the winner. The system's importance extends far beyond the rulings handed down in individual cases, because its very existence helps to defuse tensions that inevitably arise in commerce among nations. When a country's politicians and citizens are up in arms over another country's trade practices, bringing a case to the WTO can help lower the political temperature. Instead of lashing out by unilaterally imposing sanctions, which might well provoke retaliation and counter-retaliation, a country's

3 Prominent among these institutions: the State-owned Assets Supervision and Administration Commission, a giant holding company for SOEs in sectors deemed strategically important; Central Huijin, through which Beijing manages policy at the nation's big four banks and some smaller financial institutions; and the National Development and Reform Commission, which coordinates policy to fulfill strategic objectives. For an enlightening explication of these institutions, see Wu (2016).

4 These include the 2006 "National Medium- and Long-Term Program for Science and Technology Development," the 2010 "Strategic Emerging Industries Initiative" and the 2013 "Made in China 2025."

5 An example is the financial information services industry. In 2006, Xinhua, China's official news agency, laid down strict regulations regarding the operations of foreign providers of financial information such as Bloomberg; when the United States and European Union took the first steps toward launching a WTO case, Chinese authorities essentially withdrew the offending regulations.

6 Wu (2016) is a particularly cogent version of this argument.

trade minister can call a news conference and righteously announce plans to pursue litigation before an impartial body in Geneva with the intention of bringing the offender to justice.

However, accusations of unfairness have often emanated from the United States. A number of US trade policy makers and members of Washington's trade community decry what they perceive as bias on the seven-member Appellate Body, the WTO's version of the Supreme Court, which weighs appeals of decisions that have been rendered by three-member panels. In this view, the Appellate Body has gone overboard in interpreting the rules to suit its predilections, showing excessive distaste for key policies the United States uses to protect against unfair trade. Washington has been throwing its weight around to correct this alleged bias for some time, as we shall see, and US assertiveness is on the rise in the Trump era.

To what extent is the WTO effective in addressing the challenge posed by China's economic system, and to what extent is it deficient? What is the merit of the US criticism, in particular regarding the Appellate Body, and how damaging to the WTO's authority are the actions that Washington has taken? Are the trade body's flaws fatal? Are they fixable? Enhanced understanding of these issues can be derived from the recounting of the two WTO cases below. Unfortunately, the unfolding of this saga also augurs poorly for the future of the rules-based trading system.

Claims and Counter-Claims

In capacious rooms at the WTO headquarters compound, which commands a splendid view of Lake Geneva and the Alps, a crowd of about 100 people gathered for three days in late February 2013 as a tribunal began considering a case

dubbed *China — Rare Earths*.⁷ For anyone prone to sentimentality about the glories of international governance, the scene afforded ample validation.

Speakers stuck to the merits of their arguments; the ineffectiveness of shouting or theatrics was well understood by all. Sitting on a raised dais were three judges — or panellists, as the WTO prefers to call them — from countries that were not parties to the dispute. The panel chairman, Nacer Benjelloun-Touimi, was a former Moroccan ambassador and WTO official; his colleagues were from Uruguay and Zambia. On one side of the panel sat legal teams from the complainants — the United States, European Union and Japan — and also present, sitting behind the panel, were a number of legal specialists from the WTO Secretariat assisting the panellists. On the second day, representatives also attended from 13 “third-party” countries that took an interest in the issues at stake.

The largest group by far, 35 people, was sitting on the defendants' side — that is, China's. It is typical for China to send much bigger delegations than any other WTO member to these proceedings, which some of the Americans find off-putting, especially since Chinese participants are often seen carrying shopping bags from fancy Geneva boutiques and get ferried to and from their hotels in a fleet of luxury sedans. (The US mission in Geneva uses a minibus to transport the trade lawyers sent from Washington and other US personnel.) Moreover, nearly all of the Chinese attendees stay silent, leaving most of the talking on their country's behalf to high-priced attorneys from foreign firms that Beijing routinely hires for representation in Geneva — in the rare earths case, these lawyers came from Sidley Austin, a Chicago-based firm that has the world's biggest practice in WTO litigation.⁸ But the size of China's presence serves a noble purpose, namely, to show officials from the affected ministries and industries how fairly and thoroughly Beijing's arguments are being heard. Officials from the Ministry of Commerce,

7 The full official name of the case is *China — Measures Related to the Exportation of Rare Earths, Tungsten, and Molybdenum* (WTO case numbers DS431, DS432, and DS433). Information about many of the episodes and arguments that were made comes from interviews, but the specific quotations cited herein from written briefs and oral presentations can be found in the panel report and Appellate Body reports on the WTO website, available at www.wto.org/english/tratop_e/dispu_e/cases_e/ds431_e.htm; and in the archive pages of the USTR website, available at https://ustr.gov/archive/WTO/Section_Index.html.

8 Also providing legal counsel to China in this case were attorneys from a Chinese firm, AllBright.

the boosters-in-chief of the WTO in Beijing, want to ensure that these other Chinese stakeholders will honour the decision and, more generally, appreciate the importance of abiding by WTO rules.

International interest in the case was high because rare earths had seized public attention during a 2010 faceoff between China and Japan. Following a collision between Chinese and Japanese ships near islands claimed by both countries, Beijing allegedly used its near-monopoly over rare earths to cut off supplies to Japan's most advanced industries. That episode did not bear directly on the WTO dispute, but it cast a spotlight on the fact that China was virtually the only country producing these strategic minerals, and afterwards, world prices of rare earths skyrocketed. The main reason for this was Beijing's policy of restricting exports (to all foreign buyers, not just the Japanese), by imposing duties on rare earths shipped abroad as well as quotas limiting the amounts.

The closer trade officials from the United States and other countries looked at what was happening, the more clearly they perceived a pattern that, they concluded, must reflect a strategy formulated by Chinese economic planners to benefit favoured industries on a discriminatory basis. China-based manufacturers buying rare earths could enjoy a significant cost advantage over foreign manufacturers, because the domestic firms were not subject to the export restrictions. The United States and the European Union had won a case against China involving a similar export policy on raw materials such as bauxite and zinc,⁹ so they decided to haul Beijing before the WTO again, this time enlisting the help of Japan, which was still smarting from the ship collision.

In written and oral arguments to the panel, the Sidley lawyers representing China defended Beijing's rare earths policy as necessitated by horrific pollution problems. Rare earth production requires floating powder from crude ores on water, to which chemicals are added, a process leading to the concentration of toxic and radioactive substances in large ponds — all of which “constitute a major environmental health risk” (WTO 2014, 75), the Chinese side asserted, adding that exposure increases the likelihood of maladies including lung lesions, skin diseases

and problems of the central nervous system. “While many countries benefit from China's resources, China stands almost alone in bearing the burden of this production” (ibid., B-77), so Beijing was entitled to limit the amount sold abroad, according to the country's legal briefs.

The Chinese legal team acknowledged that by imposing restrictions on rare earths exports — these included duties of up to 25 percent, as well as the quotas — China had technically abrogated certain WTO obligations. (The duties violated specific terms of the agreement, called the “Protocol of Accession,” that Beijing had accepted when it joined the trade body; the quotas violated general provisions of international trade law.) But one of the WTO's cardinal principles is that member countries can exercise their sovereign rights to override trade rules when there are legitimate grounds for attaching priority to other socially important goals. And one of the most important of those goals is “protection and preservation of the environment,” China's attorneys noted, citing the preamble to the 1994 agreement that established the WTO. Such rights are also clearly spelled out in provisions of international trade rules known to experts as “Article 20 exceptions,” which exempt countries from their trade obligations when human health, resource conservation or other such objectives may be adversely affected.

In rebuttal, the Americans and their co-complainants contended that China's policies were not aimed at addressing environmental concerns but were rather a clever scheme to distort markets in favour of Chinese competitors. Without disputing the desirability of reducing pollution caused by rare earths mining, lawyers from Washington, Brussels and Tokyo derided export restrictions as a poor method of solving the problem — indeed, a perversely ineffective one, since large amounts were still being mined for the benefit of Chinese firms that were enjoying low prices.

“The average 2012 Chinese export price for yttrium was 250 percent higher than the average Chinese domestic price,” one of the US attorneys said in an oral statement. “The export prices for europium and terbium were more than double the corresponding domestic price” (USTR 2013, 19). The conclusion, which was especially compelling because a similar argument had been used successfully in the raw materials case, was that “China's measures undermine core principles of the multilateral trading system —

⁹ The full name of this case is *China — Measures Related to the Exportation of Various Raw Materials* (WTO case number DS394).

they discriminate against foreign users of these materials and provide substantial and unfair advantages to Chinese users when they compete with foreign industries and workers” (ibid., 2).

Then China’s foes went even further, advancing a point of law that infuriated the Chinese delegation. According to attorneys from the United States, the European Union and Japan, the environmental justification Beijing had used for its export restrictions was not only specious, it was beyond China’s legal right to invoke. They cited precise wording from China’s Accession Protocol, noting that Beijing never insisted upon inserting the right to impose export duties even though other WTO members could. As EU lawyers put it, the terms were “carefully negotiated and crafted,” and if China was supposed to enjoy the same rights as other WTO members regarding this issue, “the drafters... would have stated it specifically” (WTO 2014, B-25).

This line of reasoning elicited an emotional reaction from Zhao Hong, an attorney who worked at China’s WTO mission. According to people who witnessed the incident, Zhao slammed the table as she spoke, reflecting her indignation that her country, where sensitivity over past subjugation runs deep, was being relegated anew to second-class status. She was regarded by many Geneva insiders as one of Beijing’s most strident advocates, and few could have imagined that she would be selected as an Appellate Body member in January 2017. But her reaction concerning the narrow issue that arose in the 2013 hearing was understandable. Suppose, after all, that China had a valid rationale — environmental, social or otherwise — for invoking the “Article 20 exceptions” in situations like the rare earths case. Should it be prohibited from doing what other countries are allowed to do simply because of a legalistic textual analysis? Such an outcome would be “repugnant,” China’s lawyers asserted in their briefs (WTO 2014, 63).

The verdict came in October 2013. Eagerly awaited though it may have been, the process bore no resemblance to the climactic scenes from courtroom dramas such as *Perry Mason* or *Law and Order*.

Justice Delayed, but Not Denied

When WTO panels render decisions, they do not summon the parties to tension-filled chambers for solemn pronouncements of guilt or innocence. Rather, they send the parties an “interim report” about their conclusions, which is supposed to remain confidential, the purpose being to receive feedback that might prompt some modifications in case panellists recognize the need. Sometimes the results are leaked, and they were in *China — Rare Earths*, although the final report was not issued until March 26, 2014.

The outcome was rightly hailed as a victory by USTR Michael Froman (USTR 2014) — indeed, it constituted a near-demolition of China’s defence. All three panellists agreed that Brussels, Tokyo and Washington had made a convincing case that Beijing’s export restrictions on rare earths were designed to promote domestic industry rather than protect the environment or conserve natural resources. “We do not consider that China has rebutted this evidence,” the panel stated (WTO 2014, 79). Furthermore, two of the three panellists ruled in the complainants’ favour on the technical issue that had riled Zhao.¹⁰ An effort by China to overturn the ruling failed when the Appellate Body upheld the panel’s decision in August 2014.

To this day, Chinese lawyers and officials seethe over the decision. But Beijing obediently implemented the order (or “request,” in WTO parlance, since sovereign nations are involved) to bring its rare earths policies into compliance with the trade body’s rules, by rescinding the export restrictions. International trade rules, and the pursuit of litigation to enforce them, had disrupted a patently unfair aspect of Chinese industrial policy — a triumph for global governance.

10 On the technical issue, the majority acknowledged that it would be “manifestly absurd and unreasonable” for any WTO member to be “legally prevented from taking measures that are necessary to protect the environment or human, animal, or plant life or health” (WTO 2014, 65). But they contended, emphasizing “how limited the implications of this finding are” (ibid. 66), that China could not use export duties for such a purpose as other WTO members could. A third panellist — whose identity was undisclosed, in keeping with WTO rules — dissented on the technical issue but concurred on the broader question of whether China’s rare earths policies violated WTO rules.

Or so it might seem; the reality was more complex. For one thing, the proceedings had taken so long that, in the interim, Beijing had achieved some of its industrial policy goals, in particular inducing foreign companies to move or expand operations to China for the sake of ensuring reliable and inexpensive rare earth supplies. Examples included a Japanese optical device maker, Hoya Corp., which established a subsidiary in China's Shandong Province to produce digital camera lenses; and a Japanese chemicals firm, Showa Denko KK, which increased production at its Chinese plant of an alloy used in hybrid car motors (Yoshioka, Nishiyama and Kogure 2011).

Therein lies a big defect in WTO dispute settlement — the lack of retroactivity. As long as China changed its policies to comply with the ruling, it would not suffer any punishment or pay compensation for harm it had caused in the past. And China is hardly the only country that has taken advantage of this weakness in the system. In one notorious case, the administration of US President George W. Bush imposed barriers on imported steel that blatantly violated WTO rules, giving American steelmakers a couple of years of protection from foreign competition until WTO judges could issue decrees against the US measures.

In the rare earths case, the economic benefits for the victors were limited for another reason as well — namely, the laws of supply and demand. Prices for rare earths had plummeted by the time the WTO issued its ruling, because production expanded outside of China (in Australia and Malaysia, for example) and firms found substitutes for some of the minerals (Beattie 2015).

Still, *China — Rare Earths* showed the WTO working pretty much as might be hoped, without undue difficulties concerning China's unique economic structure. The same cannot be said of *US—Anti-Dumping and Countervailing Duties (China)*, also known as *US — AD/CVD*,¹¹ the case that will be scrutinized next.

11 The full official name of the case is: "United States — Definitive Anti-Dumping and Countervailing Duties on Certain Products from China" (WTO case number DS379), www.wto.org/english/tratop_e/dispu_e/cases_e/ds379_e.htm.

Unlevel Playing Fields

Save our heartland America companies and workers! Cheap Chinese imports are killing our business! That was the message delivered on July 8, 2008, in Washington, DC, by a group of executives from tire companies with plants in towns such as Freeport, Illinois; Des Moines, Iowa; Bryan, Ohio; and Unicoi, Tennessee.¹²

The product line that concerned the executives was "off-the-road" tires, the heavy-tread kind used on tractors, earth movers and other agricultural and construction vehicles. In testimony to the US International Trade Commission, the executives complained that imports of such tires, mainly from China, had surged from 19 percent of the US market in 2004 to 37 percent in 2007, because the Chinese tires were priced well below comparable domestically made tires thanks to subsidies the Chinese producers received. The profits of US tire makers were shrinking, and workers were being laid off — employment in the industry had declined by more than five percent between 2005 and 2007, according to union representatives at the hearing, despite the rising incomes of farmers and strong demand for agricultural equipment.

"Imports of dumped and subsidized tires are destroying the market," Don Matter III, president of Specialty Tire of America, told the commissioners. "On average, Chinese tires undersell our prices by 30 percent." Speaking in support of the US tire makers were several members of Congress, among them Rep. Leonard Boswell, whose southwestern Iowa district included two large tire plants. "An entire domestic industry is threatened, not by healthy competition, but by the unfair trade practices supported by a foreign government," Boswell declared (US International Trade Commission 2008).

The relief the tire makers were seeking was the imposition of stiff duties on imported Chinese off-the-road tires. These kinds of duties, known broadly as "trade remedies," are allowed under WTO rules to address three types of situations. In anti-dumping (AD) cases, duties may be imposed on imports that are being sold at "less than fair value." In cases where imported goods have received government subsidies, countervailing

12 See US International Trade Commission (2008).

duties (CVD) may be imposed. And when surges of imported goods suddenly flood into a country and menace an industry's survival, the duties that may be levied are called "safeguards."

Trade remedies are the single biggest bone of contention in WTO litigation. Although the amount of goods affected by trade remedies is a small fraction of global commerce, disputes over them account for close to half of the cases on which WTO tribunals have ruled. And China is the single biggest target of trade remedies, which is predictable given the size of its export machine, but also because of the myriad and often mysterious ways in which Chinese companies receive support — sometimes directly from the government, sometimes in more subtle forms via SOEs or Party directives.

This is why *US — AD/CVD* is a landmark case: a method of assessment was needed for claims that Beijing's invisible hands are at work. Playing one of the starring roles in this dispute was the US off-the-road tire industry, although the executives who testified at the July 2008 hearing could not have known it at the time.

Many economists view trade remedies, and the US government's enforcement of them, as thinly disguised forms of protectionism that are antithetical to America's professed support of free trade. If inexpensive foreign products are widely available to American consumers, the argument goes, so much the better for the US economy's long-term prospects; the money people save will be spent on other things and resources will flow into the economy's efficient, high-value sectors. And if a foreign country wants to squander its own citizens' tax money to subsidize exports, there is little economic justification in preventing Americans from enjoying the benefits and low prices of such goods. Similar logic applies to the many other countries that have adopted variants of US trade remedy laws.

Although trade remedies are beloved in Congress for ostensibly establishing a "level playing field" on which domestic and foreign firms compete, critics deride the process as tilted heavily in favour of US producers, in particular politically powerful industries such as steel and lumber. A foreign firm can be found guilty of dumping, for example, if its prices in the US market fall below its costs of production — a sensible-sounding rule, but the method of determining costs is far stricter in dumping cases than it is in predatory-pricing

cases involving domestic firms. And where foreign companies can really get hung out to dry is if they fail to provide the US Department of Commerce with sufficiently responsive and timely answers to the department's questions about their operations. Then the department's analysts are obliged to make their calculations using information furnished by the domestic industry or other sources, which will likely result in higher duties. The results are sometimes nonsensical on their face; in a 1996 case alleging dumping of Italian pasta, for example, the DeCecco brand — well known as one of the most expensive on supermarket shelves — was found to be sold at "less than fair value" and slapped with duties of nearly 50 percent (Blustein 1996).

Defenders of trade remedies — including sincere, thoughtful free traders — counter that the system needs "safety valves" lest it lose public support entirely. In this view, persuading governments to open markets will be politically impossible unless they have the tools to protect their industries and workers against import competition that ordinary people deem unfair. Restraints on trade remedies may be necessary to prevent protectionist abuses, but if governments are hamstrung in using the laws, the constituency for free trade will dwindle.

Here is where the stormiest clash has arisen over the Appellate Body's alleged bias. In a number of cases, rulings by the WTO's top judges have sharply curbed the legal flexibility US officials believed they had to use trade remedies. The Appellate Body's decrees on safeguard rulings, for example, have made that type of trade remedy very hard for countries to use. In other cases, a method the US favours for calculating anti-dumping duties, called "zeroing," has been found in violation of WTO rules.

Embitterment in Washington over these rulings is dismissed in some quarters as little more than the arrogance of sore losers — especially since the United States has a better-than-average record in WTO disputes (Mayeda 2017). Others perceive a valid grievance about a systemic problem in WTO dispute settlement. Whether US acrimony is merited or not, the *US — AD/CVD* case has stoked it further, because of the confounding implications regarding China.

China Gets Countervailed

To understand why US — AD/CVD incites opposing passions in Washington and Beijing, it is instructive to look at how the US government concluded that China was subsidizing off-the-road tires and imposed duties to “countervail” the subsidies. This process might impress many Americans as a laudatory thwarting of China Inc.’s machinations; equally, it might rankle many Chinese as unwarranted infringement in their country’s legitimate business.

In the summer of 2007, law firms representing the US industry and unions filed thousands of pages of documents with the Commerce Department enumerating a wide array of Chinese practices that allegedly bestowed unfair advantages on the country’s tire producers.¹³ Some of these practices involved relatively straightforward grants and tax exemptions by governments at the national and provincial level. Others involved less direct forms of aid, notably cheap land, electric power and low-interest loans from China’s giant state-owned banks, even to tire companies that were struggling financially and would presumably be deemed uncreditworthy in pure market economies.

In addition, other practices involved such opacity that the conferral of benefits was impossible to detect with precision, but grounds for suspicion appeared ample. According to the documents, when rubber prices shot up around 2003, the Chinese government established a program to help tire companies cope by stabilizing the domestic rubber market, with SOEs providing the obvious mechanism for accomplishing this aim. Natural rubber, “designated a strategic commodity and industrial raw material,” came from state-owned Sinochem International Corp., Yunnan Natural Rubber Industrial Co. and Hainan Natural Rubber Group Co., which had received hundreds of millions of dollars in loans from state-owned banks; “these subsidies to rubber producers are

passed through to tire producers in the form of low prices for natural rubber,” the documents asserted. A similar process for synthetic rubber was spelled out in the documents, which identified state-owned China Petroleum & Chemical Corp. (Sinopec), the country’s largest petrochemical firm, as a major supplier of a key component in synthetic rubber called butadiene. Both synthetic rubber and butadiene were designated as “encouraged” by China’s industrial planners, the ultimate result being that Chinese off-the-road tire producers “pay at least \$63 per metric ton less [for synthetic rubber] than the market would demand,” according to the documents.

Having received those allegations, Commerce Department officials were obliged to seek China’s response. On August 17, 2007, the department sent a lengthy questionnaire to the Chinese government and three major off-the-road tire producers — Hebei Starbright Tire Co., Guizhou Tyre Co. and Tianjin United Tire & Rubber International Co.¹⁴ The questionnaire demanded that the companies submit massive amounts of information, including audited financial statements and tax returns translated into English, plus detailed data about their sales and exports of off-the-road tires, payments for land and electricity, interest costs on bank loans and purchases of rubber.

In some cases, the burden of answering so many queries leads foreign companies to throw up their hands in disgust, even when they know that by failing to respond, they are consigning themselves to the imposition of very high duties that may doom their fortunes in the US market. The questionnaire about Chinese off-the-road tires did elicit a response, albeit a frosty one, two months later.

On almost every point, China denied that its markets were rigged in the ways that the US industry claimed. Regarding the alleged provision of cheap loans for industrial policy purposes, for example, Chinese officials maintained that no such phenomena existed. “Commercial banks in China determine, based on their own independent criteria, whether to provide a loan to an applicant, what interest rate should be charged, and the appropriate term of the loan,” stated a letter submitted to the

¹³ From case no. C-570-913, on file at the US Department of Commerce Central Records Unit: Law firm of Stewart and Stewart, “Petitions for the Imposition of Antidumping and Countervailing Duties on Certain Off the Road Tires from The People’s Republic of China,” vol. 3, June 18, 2007; Law firm of King & Spalding, “Countervailing Duty Investigation on New Pneumatic Off-The-Road Tires From the People’s Republic of China: Bridgestone’s New Subsidy Allegations,” September 5, 2007; and King & Spalding, “Countervailing Duty Investigation of New Pneumatic Off-The-Road Tires From the People’s Republic of China: Additional Clarifying Information For Bridgestone’s New Subsidy Allegations,” September 19, 2007.

¹⁴ Letter (with attached questionnaire) from Barbara E. Tillman, director of AD/CVD Operations 6, to Dai Yunlou, minister counselor, Embassy of the People’s Republic of China, April 17, 2007.

Commerce Department by a Washington law firm representing Beijing, adding that market forces likewise determined other costs— land, electricity, and so on —that exporters incurred.¹⁵

China's protestations of innocence fell on deaf ears at the Commerce Department, whose officials received more evidence and conducted analyses they considered strongly indicative of Chinese government intervention in support of its off-the-road tire industry. For example, once month-by-month data was available about the prices Chinese tire exporters had paid to SOEs and other suppliers for various types of rubber, officials found numerous instances indicating "less than adequate remuneration" — bureaucratise for fishy discounts (USTR 2009a, 100-101).

Predictably, Washington soon erected protective walls against Chinese imports in the US off-the-road market. Preliminary duties levied in December 2007 sharply reduced sales of Chinese tires (US International Trade Commission 2008), and in July 2008, Commerce officials announced the final conclusions of their investigation. Hebei Starbright was hit hardest, with a dumping "margin" of 19.15 percent (meaning it was found to be selling tires at roughly that percentage below fair value) and a subsidy rate of 14 percent (Commerce Department 2008). The fact that both anti-dumping and countervailing duties were assessed irritated Beijing all the more because it represented a newly aggressive policy by Washington, which Chinese officials argued would result in "double counting," i.e., duties being piled on top of duties for the same alleged economic distortion.

Raising dudgeon in Beijing even further, the US off-the-road tire industry was only one of several in heartland America getting this kind of protection from Chinese competition. Around the same time as the off-the-road tires case, Washington imposed stiff duties on other Chinese imports based on principles similar to the ones used for off-the-road tires. They included laminated woven sacks (the heavy bags used to hold cement and large quantities of rice), circular welded steel tubes and light-walled rectangular steel pipes and tubes. In each case, China was found to be subsidizing its manufacturers of these products in various ways, notably via the provision of inputs by SOEs for

"less than adequate remuneration." Just as Chinese off-the-road tire producers were getting natural and synthetic rubber from SOEs at a discount, so were Chinese sack makers getting cheap petrochemicals, and steel tube and pipe makers getting cheap hot-rolled steel, according to the Commerce Department (Federal Register 2008a, 2008b, 2008c).

The Americans cannot treat us like this, Chinese officials thought — at least, not under WTO rules. Before long, *US — AD/CVD* was under way in Geneva, with opening arguments being presented on July 7, 2009.¹⁶

Round One: America Wins

Now it was up to panel chairman David Walker, New Zealand's ambassador to the WTO, whose fellow panellists were a South African and a Jamaican, to decide: Had China really subsidized its exports of tires and other products? Were the US duties consistent with WTO rules?

The Chinese complaint in *US — AD/CVD* was based on a number of arguments, including one involving the United States' imposition of duties on both anti-dumping and subsidy-countervailing grounds. But the most important and contentious element of China's case (and the one that this paper focuses on) concerned the definition of the term "public bodies." Adjudication on this issue was crucial to determining where, for legal purposes, China's truly private sector leaves off and China Inc. begins.

Spearheading China's legal team this time were attorneys from the Washington-based firm of Steptoe & Johnson. They contended that Beijing had been unjustifiably accused of channelling loans and other subsidies for the production of off-the-road tires and the other products on which countervailing duties had

¹⁵ Letter from Hogan & Hartson to Carlos M. Gutierrez, Secretary of Commerce, October 15, 2007.

¹⁶ As in the account of arguments made in oral and written presentations in the rare earths case, specific quotations from arguments in *US — AD/CVD* come from the panel report (see WTO 2010), and the Appellate Body report, *United States — Definitive Anti-Dumping and Countervailing Duties on Certain Products from China* (see WTO 2011) (on the WTO website, www.wto.org/english/tratop_e/dispu_e/cases_e/ds379_e.htm); as well as the archive pages of the USTR website, https://ustr.gov/archive/WTO/Section_Index.html.

been imposed. Under WTO rules, a subsidy can only be provided by “a government or any public body” — and according to the Steptoe lawyers, that description fit none of the SOEs that had provided inputs such as rubber, steel and chemicals to exporters of the products in question. Rather, those inputs had come from “corporate entities with separate legal personalities,” providing goods and services based on their own self-interested judgment (WTO 2010, A-2).

Sure, those enterprises may have been majority owned by the Chinese government, but that was an absurdly broad criterion by which the US Commerce Department had deemed them to be public bodies, the Steptoe lawyers argued. To be a public body, they continued, an SOE would have to be “exercis[ing] powers and authority vested in it by the State for the purpose of performing governmental functions” — that was a definition enshrined in international law. And to be providing a subsidy, the enterprise would have to be “entrusted or directed” by the state to do so (WTO 2010, A-2, A-3). Commerce officials had not even tried to ascertain such facts; therefore, US subsidy allegations were unfounded, according to the Steptoe legal briefs.

The US defence, in a nutshell, went as follows: do not let China Inc. get away with this.

“The term ‘public body’ should be interpreted so that subsidizing governments cannot use SOEs to avoid the reach” of rules on subsidies, US lawyers asserted (WTO 2010, A-12). In Washington’s view, majority ownership by the state was a perfectly valid criterion, because “a majority owner can control that which it owns. The majority owner of a firm normally can appoint a majority of the firm’s board of directors, who in turn can select the firm’s managers....Even if the owner does not interfere in day-to-day operations, the managers of the firm ultimately are accountable to the owner” (USTR 2009b, 12).

It was not necessary, either legally or in common-sense terms, to require evidence such as “entrustment and direction” to show that a Chinese SOE was acting on behalf of the government, US lawyers argued. That position drew support from Canada, one of the third parties in the dispute, whose brief stated: “China’s interpretation of the term ‘public body’ would render such term inutile” (WTO 2010, B-18).

The United States won — at the panel level — on that key point. “We find no legal error, in analyzing whether an entity is a public body, in giving primacy to evidence of majority government-ownership,” Walker and his two colleagues stated in their decision officially issued on July 23, 2010 (WTO 2010, 62). Although it was conceivable that a government-owned entity might be “completely insulated” from state influence over its operations, no such unusual circumstances were present in this case, so Washington was within its rights to levy countervailing duties on Chinese off-the-road tires and the other imports, the panel ruled.¹⁷

But the panel did not have the final word. China appealed, and during the week of January 17, 2011, the Appellate Body met in Geneva to discuss the arguments. By coincidence, on one of the very days that this momentous case was coming before the WTO’s top judges, their institution would come under an unprecedented assault.

Out of Alignment

Among the attendees at the January 2011 meeting was Jennifer Hillman, an American, who was then serving her fourth year on the Appellate Body. She was hoping to serve a second four-year term, but as she was about to learn, Washingtonians in high places had other ideas.¹⁸

When I first interviewed Hillman in her office in 2008 for a book I was writing, she proudly noted the artwork by her two school-aged sons on the walls and the photos of her family on her desk. Her point was that she was displaying only personal mementos rather than any that might reflect national loyalty, such as an American flag or the photo she had of herself with Bill Clinton, in whose administration she served as a high-ranking trade policy maker in the mid-1990s. In my book, I quoted her saying: “The idea is to

¹⁷ The panel’s ruling (see WTO 2010), did require some modifications in the US duties for reasons unrelated to the definition of “public bodies.”

¹⁸ This section and the one that follows are based on interviews with numerous sources who requested confidentiality, but whose perspectives and recollections of events sometimes conflicted. To the extent facts were in dispute and could not be confirmed by more than one interviewee, they have been omitted. Otherwise, the narrative of events is a composite of interviewees’ accounts based on careful cross-checking and follow-up interviews.

have objective judges. I try to make sure that the appearance matches the fact that I'm not in any way, shape, or form advocating for, or on the side of, the United States" (Blustein 2009, 279).

Hillman's office decor was a small part of the WTO's elaborate effort to enhance the dispute settlement system's authority and credibility by keeping its jurists free from any taint of partiality or bias. Each Appellate Body member is nominated by their own country, and certain economic powers (the United States and European Union prominent among them) are virtually guaranteed to get one member by unwritten tradition. But a special committee of senior ambassadors from WTO countries makes the final selections, which must be approved by consensus of the entire membership. Then, following selection, an Appellate Body member undergoes a sort of indoctrination process, often including a retreat with colleagues — perhaps at a Swiss or French resort — the purpose being to instill a strong ethos of fidelity to the WTO and the international community without regard to citizenship. Members are adjured to rule “unflinchingly,” even if that means issuing decisions against their own countries. Collegiality and consensus are also heavily stressed; the Appellate Body prides itself on deciding most cases without dissenting opinions, which sometimes requires intensive back-and-forth among members but helps reinforce the institution's legitimacy.

In *US — AD/CVD*, Hillman's influence was limited. When the Appellate Body reviews a case, only three of its seven members — called a “division” — make the actual ruling, with the division for each case chosen using a random selection system. The reason is to spread the heavy workload facing the Appellate Body among its members; the job is not full time. The division for *US-AD/CVD* consisted of Ricardo Ramirez-Hernández of Mexico, Peter Van den Bossche of Belgium and Lilia Bautista of the Philippines, so they alone had the authority and responsibility for deciding whether the panel was correct on issues such as the definition of public bodies. But the other four members get a chance to offer input at an “exchange of views” with the division, and the main purpose of the January 2011 meeting was to exchange views on *US — AD/CVD*.

During the meeting, Hillman excused herself because she had an appointment that she could not miss, with Michael Punke, the US ambassador to the WTO. A few weeks earlier, Punke had conveyed a jarring message to Hillman: the US

government would not support her reappointment to a second four-year term. This news had taken Hillman by surprise. With her combination of practical policy experience and academic expertise, she was generally held in high esteem as one of the Appellate Body's most knowledgeable and influential members. She knew that a number of trade hawks in Washington were angry about Appellate Body rulings on trade remedies — in fact, an American who preceded her had quietly bowed to pressure for departure after a single term. But Hillman herself had never served on a division that had ruled against the United States, except for one case involving a complaint that Washington had failed to properly comply with an earlier ruling on trade remedies. So she was perplexed by Punke's message.

In addition to wanting to understand the reasons for US dissatisfaction with her, Hillman wanted to know how far US officials would go. She knew she could gain a second four-year term even without the United States affirmatively offering its endorsement; in most instances, Appellate Body members who wanted a second term had gotten their wish almost as a matter of course. But if Washington was going to actively block her reappointment, the lack of a consensus among WTO member countries would automatically preclude her from serving again.

Now, in January 2011, the time had come for Hillman to receive more definitive word about her future. She and Punke met in a public lounge near the WTO's main entrance, to avoid any appearance that the US government was privately seeking to twist her arm regarding any Appellate Body decisions. Punke confirmed her worst fears, telling her that the United States would exercise its power to withhold consensus for any slate of judges that included her name. Answers to her queries about the rationale left her no less upset and bewildered than before. As a lifelong Democrat, she expressed willingness to step down if President Barack Obama preferred someone to replace her, but Punke said the administration had no particular nominee in mind, and he assured her that her professional qualifications were not at issue. Rather, he said, the administration wanted to put its own stamp on the Appellate Body, and Hillman did not align with the administration's plans for the institution.

Hillman warned that a decision to block her reappointment was bound to become public sooner or later, and it would adversely affect

both the WTO's credibility and Washington's reputation for supporting multilateralism. Moreover, any American appointed to replace her would be obliged to overcome suspicions about being a tool of the US government.

Hillman agreed there were problems with the Appellate Body; however, there was someone else whose removal Washington ought to prioritize.

Behind the Curtain

Werner Zdouc is arguably the most powerful international civil servant that nobody has ever heard of. An Austrian who heads the Appellate Body Secretariat, Zdouc regularly works from early in the morning to late at night and on weekends and holidays. He has devoted much of his career to the WTO — indeed, an extraordinary portion of his life, since he has neither a family nor many outside activities to distract him from his duties. And having accumulated encyclopedic knowledge on the issues he is confronting — his colleagues joke that he sleeps with the WTO texts under his pillow — he asserts his opinions forcefully, often with the intended effect.

A time-honoured description of the WTO is a “member-driven institution,” meaning that its Secretariat of 634 people lacks bureaucratic clout, and power resides almost exclusively with the governments of its members (in contrast to, say, the International Monetary Fund, whose management and staff wield considerable influence). But Zdouc stands out in the generally weak WTO Secretariat for the ways in which he exerts control over important decisions affecting trade policy. Appellate Body members are much too busy to read all the lengthy briefs and voluminous documents filed in the cases they review, and most lack native-level fluency in English. So, to a large extent, they depend on the lawyers in the Appellate Body Secretariat, just as judges elsewhere depend on clerks, to make sure they are informed about the crucial issues in a case, and also to draft opinions. Zdouc not only oversees these Secretariat staffers, he reviews virtually every document they submit to the Appellate Body Members, often revising their work — in other words, he effectively “holds the pen” in the drafting process for many decisions. Moreover, he participates in virtually every

important discussion members have about cases, and he is so relentless in debate that, according to numerous people who have worked with him, those who resist his arguments sometimes give up from sheer exhaustion. Some in Washington and Geneva who consider the Appellate Body too hostile toward trade remedies put much of the blame on Zdouc.

Zdouc's defenders contend that his power and efforts to exert it are often overstated. By all accounts, Appellate Body members who are reasonably up to speed on their cases have little difficulty ignoring his advice if they disagree with it. To the extent he holds sway over some of the less diligent Appellate Body members, his arguments are generally perceived as stemming from a passion to safeguard institutional respectability — in particular, ensuring that new rulings follow principles set forth in prior cases — rather than pursuing some political agenda. His overriding goal, in other words, is that the Appellate Body should be consistent.

But his zeal, critics contend, surpasses the limits that should constrain an ostensible technician, and reflects a stubborn refusal to allow the Appellate Body, which is not legally bound by precedent, to admit and rectify past mistakes. That was the view held by Hillman, whose former WTO colleagues recall her griping that Zdouc had utterly lost perspective. She was often at loggerheads with him during her tenure and grew increasingly confident in telling him to stop intervening. When she found her reappointment threatened, she implored Punke and other US officials to realize that dumping her would probably mean losing a chance of moving Zdouc out of his job.

Hillman's pleas were in vain. As she learned in the weeks and months after the meeting with Punke, control over the decision to replace her lay firmly in the hands of Timothy Reif, the general counsel of the Office of the USTR, who made no secret of his displeasure with the Appellate Body. Reif was convinced that the body's previous rulings on trade remedies had grossly twisted the wording in agreements that US officials had painstakingly negotiated at the WTO's inception — an example being the one division on which Hillman participated that ruled against the United States. He and a handful of colleagues in the trade representative's office, including Punke, wanted US judges to have an impact on the direction the Appellate Body took on trade remedies, perhaps by actively dissenting in cases,

and disrupting the body's treasured collegiality, even if they were not on the divisions making the rulings. Hillman had shown no inclination to go that far; Reif was adamant that she must go.

The six other members of the Appellate Body were continuing their exchange of views on *US — AD/CVD* while Hillman was meeting with Punke, and upon her return they were indignant to hear that the US government was blocking her reappointment. A discussion ensued about the possibility of recruiting officials from other countries to confront the Obama administration over the matter. But at the end of the day, there was agreement that no matter how appalled other countries' officials might be, they would not be able to influence the course of events. Hillman would have to raise the issue with other policy makers in Washington, the risk being that the news media would catch wind of what was going on (which did in fact happen) (*Inside US Trade* 2011).

Discussion then resumed on *US — AD/CVD*, with Hillman voicing strong opposition to China's stance on "public bodies." Although she did not endorse the US position that an enterprise majority-owned by a government was automatically a public body, she derided the definition favoured by China — "vested with governmental function or authority" — as far too extreme and difficult to prove.

The exchange of views ended without a clear indication of how the division would decide that matter. But when the ruling was issued two months later, on March 11, 2011, Hillman was thunderstruck, because the three members of the division had reached conclusions far different from what she had expressed or expected. She complained vociferously, some of her colleagues recall, and she could not help wondering whether the division members had dismissed her views in part because they knew she would not be around much longer anyway.

The Decisive Round Goes to China

Appellate Body decisions are long — one reason being to assure all parties that their arguments have been carefully considered — and *US — AD/*

CVD was no exception. Following an introduction, the decision devoted 42 pages to reciting China's arguments, 34 pages to US arguments, 18 pages to third-party arguments and 124 pages to analysis and conclusions. But stripping away the legal mumbo-jumbo and laying bare the essence, here was the main take-away from the Appellate Body's ruling: a country that imposes duties on Chinese imports because of alleged subsidies must have very strong evidence that Beijing is truly subsidizing. Simply showing that an enterprise is owned by the Chinese government will not suffice to demonstrate state involvement.

That, of course, was a reversal of the panel's decision. It meant that the United States had lost on the most important issue — how to discern intervention by China Inc. — and was therefore violating WTO rules by levying such heavy duties on Chinese off-the-road tires and other products.

As if this were not bad enough from Washington's perspective, the Appellate Body drew liberally from international legal principles — specifically, a United Nations code (United Nations 2008) — that US government attorneys had dismissed as an academic irrelevancy. This code determines when a government can be found liable for breaches of international obligations. For example, is Russia legally accountable for atrocities inflicted by pro-Moscow paramilitary forces in Ukraine? Such a question might appear on the surface to have little if any bearing on *US — AD/CVD*, but China used the code to bolster its argument that for a Chinese SOE to be deemed a subsidy-providing public body, it must be "vested with governmental function or authority" and its acts "entrusted or directed" by the state (WTO 2011, 16–19). To elevate the intellectual loftiness of their case, China's attorneys even enlisted James Crawford, a Cambridge professor who was lead writer of the code, as a member of their legal team.

The Appellate Body agreed with China: "A public body...must be an entity that possesses, exercises or is vested with governmental authority," the ruling stated, and overturning the panel on a number of points, it continued: "the mere fact that a government is the majority shareholder of an entity does not demonstrate that the government exercises meaningful control over the conduct of that entity, much less that the government has bestowed it with governmental authority" (WTO 2011, 123).

The decision was not a total Chinese victory. The Appellate Body ruled that China's giant state-owned banks were public bodies, because their legal charters clearly vested them with the authority to function for purposes specified by Beijing; therefore, their loans, if found to be artificially cheap, might be subject to countervailing duties.

But critics assailed the ruling as effectively giving China *carte blanche* to subsidize its industries and manipulate its markets in other ways, considering the impracticality of showing conclusively that the Chinese authorities had induced a state-owned company to take a particular action. "The conditions required by the [Appellate Body] for a determination that an SOE is a public body... constitute an excessively burdensome test," wrote three former trade officials (none of them American) in a leading journal. "Interpretation of [WTO] rules must...avoid awkward and incoherent results that do not reflect realities of international trade" (Cartland, Depayre and Woznowski 2012). The authors had all been heavily involved in negotiating the terms of WTO rules on subsidies, which lent extra credence to their complaint that the Appellate Body had failed to interpret the rules as the drafters had intended.

The United States did not take this defeat lying down. On May 18, 2012, the Department of Commerce issued a memorandum setting forth how it would comply with the Appellate Body decision — and it was essentially a plan to make it easier than ever to impose countervailing duties on imports of Chinese products, in ways that would drive Beijing crazy.¹⁹

The WTO's top judges had made it clear, the memo noted, that a high standard of evidence was required for identifying a Chinese public body — specifically, "a proper evaluation of the core features of the entity concerned, and its relationship with the government." So in future subsidy investigations, Commerce officials would submit questionnaires to China demanding all kinds of new information from Chinese enterprises that might be conduits for subsidies, including the roles played by Communist Party members in their

management and boards of directors. Indeed, the memo showed that the Commerce Department was prepared to be more aggressive than before in identifying public bodies, which might even include private firms with Communist Party managers and directors. And, of course, if China refused to supply the requested information, Commerce officials would be legally allowed to assume whatever facts would result in the highest duties.

The upshot is that Washington's loss in *US — AD/CVD* has had no impact so far on the US economy or economies elsewhere; the floodgates have not opened wider to imports of subsidized Chinese goods. But the reasoning in *US — AD/CVD* may have broader implications than the area of trade remedies. If it is necessary for those complaining about China's system to show definitively that Chinese authorities are quietly intervening in all manner of decisions — say, concerning demands for the transfer of technology — challenging Beijing in the WTO will become much more daunting.

Conclusions

Two WTO cases: one shows that the tribunals in Geneva can readily handle the China Inc. problem; the other raises disconcerting questions about whether the trade body's rules apply to the most problematic aspects of the Chinese system as it has evolved in the years since WTO entry. Taken together, they illustrate that the WTO is far from perfect regarding the quandaries posed by China's rise, and in need of improvements on other issues as well, but well-suited in many respects to fulfilling a mission that is essential to global stability.

Developments in the years subsequent to these two cases have exacerbated the woes afflicting the WTO, which is already struggling to maintain its centrality in the trading system in the aftermath of its long, painful failure to modernize its rules in the Doha Round of global negotiations.

During the presidency of Xi Jinping, which began in 2012, China has moved even further away from the market-opening reforms of the early 2000s toward a statist approach aimed at attaining domination for Chinese firms in nearly every industrial sector. Among Western economists and other experts who fervently backed China's admission to the

19 Memorandum to Paul Piquado, assistant secretary for import administration, "Section 129 Determination of the Countervailing Duty Investigation of Circular Welded Carbon Quality Steel Pipe; Light-Walled Rectangular Pipe and Tube; Laminated Woven Sacks; and Off-the-Road Tires from the People's Republic of China: An Analysis of Public Bodies in the People's Republic of China in Accordance with the WTO Appellate Body's Findings in DS379," May 18, 2012.

WTO, it has become commonplace to ruefully acknowledge that Beijing adheres to the letter of the trade body's rules, but not the spirit.

American deprecation of the Appellate Body, meanwhile, has reached new levels of intensity. In 2016, Washington publicly vetoed the reappointment of another member, South Korea's Seung Wha Chang, charging that some of his decisions egregiously deviated from acceptable boundaries of jurisprudence. The United States was totally isolated in taking this action, and plowed ahead despite scant evidence that it had reaped much benefit from removing Hillman. The American who replaced her, Thomas Graham, is well regarded in Geneva, but has dashed the hopes of Washington trade hawks for an aggressive advocate. More recently, the Trump administration has held up the filling of two Appellate Body vacancies at a time when a heavy backlog of cases has accumulated. As *The Economist* (2017) put it, the administration is "hold[ing] the WTO hostage" in an apparent effort to ensure that future Appellate Body rulings are more to Washington's liking.

This is the sort of browbeating that could destroy the WTO's value. If member countries lose faith that they will get fair hearings in Geneva, it will be only a matter of time before they resort to other approaches for resolving disputes, including taking matters into their own hands.

Complaints about the Appellate Body are not wholly misplaced, as this paper has shown. Any court makes mistakes, and if Werner Zdouc is keeping the WTO's top judges from squarely facing theirs, he should find a different job — not because he has acted dishonourably (he has not), but because concerns about his loss of perspective are apt. However, it would be the ultimate loss of perspective — indeed, the ultimate throwing out of the baby with the bathwater — if the United States were to wreck the WTO out of pique over Appellate Body rulings on trade remedies.

The much thornier and more consequential question is whether the WTO can survive the continued rise of China Inc. and the US response. For all its flaws, the WTO constrains Chinese policy within certain bounds — recall the respect for WTO rules that impels large delegations from Beijing to attend dispute settlement hearings in Geneva. Is this degree of constraint sufficient? Making the affirmative case has become increasingly difficult in recent years. Trump and his trade team clearly

believe in the need for other tools, including the possibility of unilateral sanctions against unfair trade practices, which Washington imposed during the pre-WTO era of the 1970s and 1980s and are of uncertain legality under WTO rules.

It is pleasant to contemplate a scenario in which the United States and China both exercise the leadership necessary to keep the WTO relevant, credible and effective. In view of the Doha Round's collapse, the prospect of negotiations at the global level is probably a pipe dream at this juncture. Short of that, Beijing could take measures on its own to give foreign companies more access to the Chinese market without imposing unreasonable conditions, and Washington could eschew unilateral sanctions while also adopting a more hands-off attitude toward the Appellate Body.

But most signs point in the other direction, toward China maintaining heavy-handed industrial policies that the WTO cannot or will not deem illegal, and the Trump administration going ballistic — perhaps to the point of WTO withdrawal — as soon as the United States loses a major case in the Appellate Body, which could easily happen in the next year or two. For those assessing the merits and demerits of such outcomes, the stories of *China — Rare Earths* and *US — AD/CVD* may provide little comfort, but hopefully some enlightenment.

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