International Trade and the End of Textile Quotas (Part Two)

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In last issue, we Published Doctor's speech on international trade and the end of textile quotas which was highly welcomed,so here is the second part of his analysis:

What May Happen When Cases Are Brought

These, then, are the kinds of actions that could be brought against Chinese textiles and apparel after the quotas expire at the end of the year. When petitions are filed, they are processed quickly. Respondents – that would be you – have little time to answer. Typically, Chinese parties lose a lot of time selecting counsel. They often miss entirely the first, important part of the legal proceedings because they are not ready, and they have great difficulty assembling the documents and answering the questions demanded of them when the cases begin. They worry more about what legal services will cost than the quality of the legal services they will receive, and more about spending on the legal fight than what might happen if they were to lose. And when the battle with the U.S. agencies more often than not is lost, they give up, even though the real battle would be in the U.S. courts. They wonder why they spent so much time and money on the investigation without appreciating that the record created in the investigation is what is

essential for the court fight. You, however, are being warned. Four months from now, you may begin to be subject to petitions demanding the reimposition of quotas or the imposition of duties against your products. There are things you can do, and you should start doing them now.

How The System Works And What You Can Do

Safeguards

It is difficult to stop the initiation of a safeguard action, but not so difficult to round up allies for the proceeding, and allies matter a great deal. Retailers and importers may testify. The burden on the domestic industry to demonstrate injury caused exclusively by Chinese imports is a heavy one. Even when the International Trade Commission finds injury, other agencies must concur. The White House must concur. Even then, there is a separate proceeding to determine a remedy, and a whole second chance to defend against serious consequences. Nonetheless, the proceeding moves quickly. It would be better to self-regulate and avoid credible allegations of a surge, rather than rely on defeating claims of serious injury.

No party in the United States can complain, under any of the trade remedy actions available, unless they make the same product with which they are competing or one sufficiently similar that the Chinese product could substitute for the American product. This area of the law is complex and sophisticated, and you would need the help of American legal counsel to work with it effectively. Nonetheless, you can take some general steps. It is equally important for dumping and subsidies cases as it is for safeguards.

First, you can determine whether anyone in the United States is producing exactly the same product by asking your importers or the retailers in the United States selling your products. You surely know about your competition, and if you do not, you should. Find out something about your competitors: how much of your product do they make? Are their prices lower? How much does their business depend on the particular product? You can make some judgments about how likely it is that they would go to the expense of filing a petition against you. You can also judge whether there is any competition – any of what is called in the law a "like product" – such that there is any industry in the United States directly hurt by having to compete with your products.

Second, you can consider whether, where there is direct competition, there is anything you could do to distinguish your product, to make it different from the one with which you are competing, perhaps into something that would give it a different tariff code. Perhaps there is something unique you could patent (we can help). You can try to produce something different from what is otherwise competing directly with your product.

Assuming there is a product competing directly and manufactured in the United States, you can do some things to prepare for possible allegations about a surge of exports. You have, or can easily access, the statistics showing the growth in your exports during the last three years. You can assemble those statistics by product or harmonized tariff number, certainly under the auspices of the association. You could agree, voluntarily and unofficially, on a gradual growth in exports so that you do not create a legally cognizable surge. We could help you sort through the statistics and set targets

or ceilings for export growth. A petitioner looking for safeguard protection must first show there is a surge. You could take planning steps now, product by product, that when implemented would deprive a potential petitioner of a surge complaint.

There are potential hazards in this strategy, although the rewards are great. You have a new anti-monopoly law in China, modeled somewhat on anti-competition and antitrust laws in western countries, so you may be aware of the legal concept that presents a potential problem. The law in the United States, which is extra-territorial – meaning, it can be applied to activities and companies outside the United States provided they do any business in the United States – forbids the collaboration of companies to set prices or to divide up a market. To expand into the market rationally and without a surge, it would be necessary to harmonize exports. Here, governments are permitted to take the lead, whereas private enterprises are forbidden from getting together on their own. This kind of collaboration with government is acceptable, and in circumstances such as yours, even encouraged, but you want to avoid having the government direct which companies will be allocated different market shares. With government oversight, and the guidance of counsel expert in the antitrust laws of the United States, you ought to be able to make those choices yourselves.

Antidumping

You control the price of your product, which is why the companies, and not the government, must address dumping allegations. An important problem, however, is that in the presence of non-market economy status, you do not fully control the calculation of your costs of production. You may be producing at costs comfortably below the price you set for sale, but the surrogate values the U.S. Commerce Department may use may inflate significantly the calculation of your costs. Your bigger problem, however, is that in not knowing intimately how these calculations are done, there is really very little you can do on your own to help yourself.

We can help you with this problem. Although we cannot prevent dumping allegations from being made, and we cannot guarantee that they will not to some extent succeed, we can help put your books in order, organize them as the Commerce Department expects them to be organized, and manage your costs enough to guarantee that, upon investigation, you would face a smaller and more manageable dumping margin than if you were to have done nothing in anticipation of a possible case. The dumping margin determines the amount of duties to be applied to your product, raising its price in the foreign market, and therefore whether you can afford to remain competitive.

The American system, unlike the European, is based on a theory of deterrence: you are not necessarily punished for past deeds; you are to be persuaded to cease doing the thing considered wrong. If you stop doing it soon enough, you can avoid all penalties.

In practical terms, assuming you could manage to post substantial bonds during a first year of an antidumping order (putting up money on a promise of later payment), if you were to have prepared in advance you would be able to set your costing and books for the second year of the case. You would have some knowledge of the Commerce Department's calculations and surrogate values. Actual duties are charged only in the second year. The bonds or

deposits you may have posted could be returned to you in full.Many companies, however, cannot afford the deposits and effectively are put out of business. Others do not welcome, or cannot afford, the extra legal work to position themselves for a second year of investigation. These steps, nevertheless, can save the company from losing its business, and perhaps the association would assist individual companies with legal expenses, at least those named as mandatory respondents in investigations, because the rates derived for them will become the rates set for everyone.

This reference to "mandatory respondents" is important for you to understand. One of the biggest problems China has encountered in these cases is that companies selected by the U.S. Department of Commerce for investigation often have refused to cooperate, or have cooperated unsuccessfully as far as the Commerce Department is concerned. The Commerce Department selects a small number of companies to represent entire industries. The investigative results for those companies are applied to all the companies not selected. When a company refuses to cooperate, the worst possible results automatically are applied. It is important for selected companies to participate and cooperate. When they cannot afford counsel, the relevant associations should share their legal expenses because everyone in the association will be affected by the outcome.

Those of you not making anything for which there is a direct competitor, or a product for which yours would easily substitute, need not concern yourselves with this particular exercise of cost management or control. You do, however, need to concentrate on another aspect of the trade law, to which I will turn in a couple of minutes.

Subsidies

The National Council in the United States is especially exercised about subsidies, claiming to have identified seventy benefitting textiles and apparel. The Council is more interested now in bringing subsidies cases than in pursuing dumping, although in most instances petitions will be filed alleging both subsidies and dumping.

These alleged subsidies are the primary responsibility of the Government. However, we have found that MOFCOM in Beijing does not have full knowledge of all other ministries in Beijing, nor of provincial and county governments. Nor do all of them fully cooperate with MOFCOM. And we have found that the most important alleged subsidies may be at the local – provincial and county – levels, where MOFCOM seems to have difficulty in gathering information. We encountered specific and serious problems this year right here in Shandong Province.

A critical part of the subsidy allegations requires individual companies to demonstrate, on the books of each company, whether they have received benefits from one or another program. Chinese governments generally do not keep track of which companies use a tax program, or receive a research and development grant. U.S. officials have accepted that, for many of the programs alleged, they must examine the books of the companies involved and cannot rely on MOFCOM to answer their questions.

Every textile and apparel company can examine its own books to determine whether it is benefitting from loans from state-owned banks, or being forgiven taxes because of the products it makes, or whether it is doing business with state-owned enterprises. Every company can recount how it acquired rights to use land, and what it paid. In several domains, each company can assemble what might be alleged as subsidies, and we can help determine which may be defensible, which less so, and what might be done (such as the accelerated repayment of a state bank loan) to reduce exposure to a trade remedy action. Thus, at the company level, there is a great deal that can be

done to reduce the risks of a case, and to be ready to respond should one be filed.

One more word of caution: companies that have sought to hide company information about subsidies typically end up with much worse results – much higher duties – than companies that are open about their books and records and rely on experienced American counsel to explain to U.S. government officials why they should not be concerned. Chinese companies are reluctant to trust American lawyers, but they are then less successful defending their economic interests.

Injury

Whereas the Commerce Department decides whether a product is dumped or subsidized, the International Trade Commission decides whether an industry in the United States is injured, or threatened with injury, by imported goods that are dumped or subsidized. When there is no injury or threat of imminent injury, no duties can be imposed, even when dumping or subsidies are found. The Commission must first establish, in making this determination, that there is direct competition between the foreign and a domestic product.

The Commerce Department is a very difficult place for foreign interests because the Department exists to help U.S. companies and industries. Its investigators are determined to find Chinese companies dumping or being subsidized. It is willing to distort or pervert the law to get those results, knowing that many Chinese companies will then give up and not go through a judicial appeal. Often the findings are so outrageous, as to the law, that they would be easily overturned in front of a judge, but the Chinese, in particular, tend not to appeal and therefore no judge hears the findings to overturn them.

Unlike the Commerce Department, the International Trade Commission has a much better reputation for being fair. It is less than perfect, and often its determinations and findings also need to be appealed to a judge. Nevertheless, there is a better chance, at the agency level, of prevailing as a foreign interest before the International Trade Commission than before the Commerce Department.

MOFCOM has declined to participate in any of the injury cases before the Commission. We do not know why. It is before the Commission that Chinese industries have a better chance of winning. The Laminated Woven Sacks case, which is the model being used by the National Council of Textile Organizations to bring cases against Chinese textiles and apparel, involved an extremely weak claim of injury and even of like product before the Commission, but only one Chinese company showed up to argue there, and apparently did not invest enough to mount the best case and win.

In dumping and subsidies cases, the Department of Commerce decides whether a company is dumping, and whether it is subsidized. In both instances, because it treats China as a non-market economy, it has enough discretion to find against the Chinese company and does so almost very time. Every company is competing with every other company, because when one

Chinese company gets a lower rate than another, it has a competitive advantage over that company. For this reason, companies need their own and separate counsel. The Commerce Department, moreover, names mandatory respondents – companies that must answer questionnaires and participate fully in the investigation. Companies that do not cooperate after being named are severely punished and typically are locked out of the U.S. market.

Many Chinese companies, in order to save money, hire the same lawyers to represent them and other companies. The American lawyers who represent them this way should not do so because there are conflicts of interest – the Chinese companies, competing with each other, should not have the same counsel because the counsel cannot properly choose between them on every issue. Each company named as a mandatory respondent needs its own legal counsel, even though the trade association could agree to pay the counsel for each one because all members of the association are affected.

When the cases are before the International Trade Commission, the situation is different. The Commission must find that an industry in the United States is being injured, or threatened with injury, by an industry in China. The Chinese industry, therefore, can take on the matter in this forum collectively and share the expense without concern for counsel or companies in conflicts of interest. A single counsel could represent the Association.

The Commission, unlike the Commerce Department, must examine the U.S. industry, and it must establish that foreign products are competing directly with U.S. products. For textiles and apparel, this fact is very important.

The Big Problem Faced By American Producers

We have found that China's most formidable role in the U.S. market is in apparel, but the interests organized against China are in textiles. The U.S. textile organization has been trying to rally apparel manufacturers to its cause, but so far with limited success.

The textile manufacturers are so exercised for two reasons. First, Chinese exports to the United States of textiles have been increasing, but second and more important, the U.S. textile manufacturers sell their products with special trade advantages in the Americas, especially in the Caribbean, where clothing is made and sold back into the United States. As Chinese clothing competes more successfully with the clothing made in the Americas (especially in Mexico and around the Caribbean), the demand for the U.S. textiles, used to make the clothing outside the United States, is declining. So, the textile manufacturers are losing sales because of the indirect competition from China.

This indirect competition is not a basis for trade remedy actions. The National Council of Textile Organizations would not have legal standing to initiate cases against Chinese clothing. The legal battle on these issues, however, is to be fought before the International Trade Commission, where Chinese interests have tended not to appear, or to appear effectively.

This legal standing problem explains the pressure the National Council has been bringing for a monitoring system. Currently, the Department of Commerce monitors Vietnamese imports, and no trade action has been triggered. Allies of Chinese textiles and apparel have argued that the monitoring system is a waste of money, referring to the failure of the Vietnamese monitoring to lead to any actions. However, the National Council argues that there will be surges with the expiration of the quotas, and that the surest way to stop those surges is to be monitoring for them and for the Commerce Department to self-initiate actions without delay when they occur. The National Council's theory is that, were there to be

any basis for a trade action arising from a post-quota surge, self-initiation would eliminate the requirement for a petition from a U.S. industry, and thus overcome the problem of standing.

So far, Commerce has not proposed to extend the monitoring to China, and Congress does not appear ready to fund it. Nevertheless, it remains a possibility designed to overcome what otherwise could be a fatal problem for the U.S. textile manufacturers.

There is a further legal test that presents a serious problem for the U.S. industry. It must show before the International Trade Commission that the cause of injury is expressly Chinese imports and not the imports of some other country unless that country is also named in the case. Where Mexico, for example, is an important foreign supplier, and is not likely to be named in the case because the National Council of Textile Organizations is busy building an alliance with Mexico against China, the complaining U.S. industry would have to prove that Mexican imports are not a source of injury and that the Chinese imports can be isolated as a source of injury. Such an argument is very hard to prove, and the International Trade Commission repeatedly has lost appeals over this legal issue.

Our advice, therefore, is to pool resources to develop defenses focused at the International Trade Commission on like product and on third country contributions to injury. That work can begin in anticipation of cases to be brought next year, making it much easier to mount the defense at the proper time, and in the end it will be more cost-effective.

Conclusion

There are some things you can and need to do individually as companies, and some things you can do collectively as an association. Individually, you can prepare your books and reset your pricing. You can identify all possible subsidies and decide what to do about them. Although no law firm should represent more than one company individually in an actual investigation and appeal, because of conflicts of interest that inevitably develop in the course of a case, one law firm could help any number of you prepare should you eventually be named as a mandatory respondent. Once named, you might require other, additional counsel.

Collectively, you should organize, with the help of the government, to control surges and manage the expansion of your trade so that you are not overexposed to safeguard actions. And collectively you should develop defenses, with the help of counsel, at the International Trade Commission, by focusing on your competitors and your products, considering how you might differentiate your products from products made in the United States, and by examining third-country competition.

Another option you might consider: some of you may be cash-rich. The dollar is weak. It is a good time to buy competitors. So, should any of you identify major U.S. competitors for your specific products, you might want to consider buying them out. They cannot petition against you if you own them. Some smaller version of the industry might, but it becomes that much more expensive for them to do so. You would not be the first to pursue such a strategy. It works.

There is no good reason to delay undertaking any of these steps, unless you truly believe that, after hundreds of years of trade restrictions on textiles and clothing, protectionists will permit, just three months from now, free trade.