Attack On China Rolls On New Tires

by

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The United Steelworkers, qualifying as an "entity" "representative of an industry" under Section 201 of the U.S. Trade Act of 1974, petitioned the Obama Administration in April 2009 to enact a temporary "safeguard" remedy to protect the manufacture and sale of low-grade commercial tires in the United States against a surge of imports from China. *Petition Seeking Relief from Market Disruption Caused by Imports of Consumer Tires from China, Inv. No. TA-421-07, April 20, 2009*. Even though the union filed the petition without cooperation or support from any company manufacturing tires in the U.S., and safeguards exist primarily to protect productive industries, the Obama Administration is under exceptional political pressure to honor the union's request.

The special safeguard law for China, Section 421, expires in 2012 in accordance with China's Protocol of Accession to the World Trade Organization. Thereafter, China will be subject only to the same safeguard provisions as every other country. Until then, the Obama Administration will have to weigh its relations with China against domestic interests and priorities. All safeguards, uniquely among trade remedies, require presidential decisions.

The United States International Trade Commission ("ITC") issued a report on June 18 finding "market disruption," the statutory basis for recommending trade relief for a domestic industry under the special safeguard for China. The ITC recommended, on July 9, three years of very high but gradually reducing tariffs. Ten United States Senators then wrote President Obama endorsing the ITC recommendations.

Relying on the ITC record, a Trade Policy Staff Committee ("TPSC") assembled for this case and comprised of the Departments of State, Commerce, Labor, and Treasury, chaired by the Office of the United States Trade Representative ("USTR"), must make its own recommendation to the President as to whether he should grant any relief to the industry and, were he to do so, how much and in what form. The final public hearing on the case, convened by the TPSC, was held in Washington, D.C. on August 7. All written submissions were due from all parties by August 11.

The statute provides expressly for settlement of disputes where market disruption has been found, but should China want to settle this dispute, it must do so by August 17. The TPSC is expected to make its recommendation to the President by September 2. In the absence of a settlement, the President must decide the question of remedy for the market disruption found by the ITC by September 17.

China's strategy in this case has been to adopt a "Republican" political and policy position – that the market forces surrounding the choices of the companies to give up the manufacture of low-grade tires should govern, allowing thousands of jobs to move offshore to lower cost manufacturers. China's opposition to safeguard remedies has been articulated as a preference for market forces over the employment of American workers, and for economic analysis that contradicts the ITC's report. Advocates for the Chinese side have given the law little attention.

The Chinese strategy opposing the imposition of safeguard remedies neglects both the politics of the American two-party system, and the legal purpose of safeguard provisions. Its reliance on dueling economic analyses, instead of law and a keener appreciation of the political situation of the President, probably will mean that the special safeguard for China will be applied for the first time. China may have something still to say, however, about the severity of the application.

The President is not likely to provide the full measure of relief proposed by the ITC because he may not want to gamble on the predictions that the tariffs would be prohibitive and cause even more market disruption, but he may be inclined to provide more "relief" than China would find acceptable. The August 17 deadline is not absolute (the statutory language instructing that the Trade Representative "should seek to conclude such agreement before the expiration of the 60-days consultation period" would seem equivocal enough were China to express immediately a commitment to a politically sensitive settlement). The statute also permits later review, on the President's initiative, for modification, reduction, or termination of imposed relief. Mutual sensitivity to the domestic political implications of this case in both China and the United States could lead to an amicable compromise, albeit probably somewhat unsatisfactory (as compromises and settlements are supposed to be) for everyone.

The Law And Its Purpose

The concept of a "safeguard" in international trade is based on enabling industries facing a surge in imports from foreign countries to adjust to new market circumstances. A safeguard remedy is temporary, designed more to assist a besieged industry than to punish a foreign one because there is no legal basis for punishment – a safeguard does not involve any examination as to whether a foreign product is fairly traded. It matters only that exports are surging and that the surge injures domestic industry.

Safeguards are exceptional trade remedies for two reasons: they do not require unfair trading, and they may result in a quota or tariff rate quota. Quotas in all forms are otherwise banned by international trade rules. They are permissible only as a remedy in a safeguard action.

Section 201 of the U.S. trade law implements the Uruguay Round Agreements on safeguards. In two critical respects, it is different from the special China safeguard, Section 421 of the trade law, that was introduced in 2000 as a condition for China's accession to the WTO.

Section 421 replaced, for China, Section 406, a safeguard provision directed to Communist countries. Some lawyers thought of Section 406 as deliberately punitive in design, that Communist countries causing market disruption could be punished with trade restrictions because disrupting markets, when done by command economies, itself would violate international trade rules. However, Section 406, after setting out a weaker standard to justify imposition of a remedy, then referred to Sections 202 and 203 of the trade law, which specified that a remedy needed to help an industry adjust to changed trade conditions. It was always expressly a safeguard, not merely a reaction to market disruption.

Negotiators of Chinese accession to the WTO thought it important to subject China to a special safeguard because of widespread concern that China could overwhelm world markets with certain goods. China accepted such discipline because of its determination to be accepted into the community of world trading nations. *See* Fabio Spadi, *Discriminatory*

Safeguards In The Light Of The Admission Of The People's Republic Of China To The World Trade Organisation, 5 Journal of Intl. Econ. 421 (2002).

The principal difference between Sections 201 and 421 is in the standard for injury. Because a trade remedy can be imposed on fairly traded goods, Section 201 requires a higher standard for injury than applies for antidumping or countervailing duties. After all, it is particularly serious to limit trade in something where no international trade rules have been broken. Section 201 specifies that a petitioner seeking safeguard protection must demonstrate serious injury, a standard the statute does not define but that the ITC has treated as higher, and more demanding, than ordinary, or "material" injury.

The special safeguard for China does not require this higher standard for injury. It requires only that there be "market disruption" from a surge, defined as an increase in imports "so as to be a significant cause of material injury, or threat of material injury." The requirement that the market disruption be a "significant" cause of injury is a higher standard than in other trade remedy actions, which require dumped or subsidized goods to be "a" cause, but the injury itself need not be "serious." It is understood that this difference in standard makes it easier to petition for a safeguard remedy against Chinese goods than against goods from any other country.

The second distinction has been little noticed but may be, particularly in the tires case, more important. Section 201 expressly requires domestic industry to present a persuasive adjustment plan. The idea is that a remedy must reasonably be expected to provide a cure. A domestic industry may receive relief for as many as four years (and under extraordinary circumstances, may have relief extended to a maximum of eight, which has never happened). *See* 19 U.S.C. § 2253(e)(1)(A)("the duration of the period in which an action taken under this section may be in effect shall not exceed 4 years"), and 19 U.S.C. § 2253(e)(1)(B)(ii) ("The effective period of any action under this section, including any extensions thereof, may not, in the aggregate, exceed 8 years."). Ordinarily, relief does not exceed three years.

During the period of safeguard relief, domestic industry is expected to implement a plan that will enable it, when the relief expires, to compete under the new circumstances of increased foreign competition. Were there no reasonable expectation that the temporary relief could lead to a permanent improvement in the ability of the domestic industry to survive and prosper, there would be no reason for relief.

The special safeguard for China makes no mention of an adjustment plan, nor does the provision in China's Protocol of Accession to the WTO that authorizes the special safeguard for China. The subject does not appear to be mentioned in the legislative history in the United States, nor in the negotiating history of the Protocol, but Terence Stewart, petitioner's counsel in the tires case, complained in 2005 testimony that the ITC was requiring an adjustment plan despite its absence from the statute. *See* Terence B. Stewart, *Statement Evaluating Available Trade Remedies before the U.S. –China Economic and Security Review Commission* (February 3, 2005). It seems, then, that the ITC understood Section 421 as safeguards were generally understood in the creation of the WTO, and assumed that the purpose of a safeguard could not be met without an adjustment plan, even though the specific provisions of Section 421 neglected to say so. Section 406, after all, which Section 421 was meant to replace, expressly referred to Section 203, which required a remedy that would involve adjustment for the domestic industry.

The Legal Dilemma Of The Tires Case

The Section 421 petition seeking relief from market disruption caused by a surge in the export of commercial tires from China to the United States was filed by the United Steelworkers, a trade union. No company – no manufacturer of tires – joined in the petition. Since the matter got underway in April, no company has appeared to take a position, not before the ITC, where formal safeguard proceedings begin, and not before USTR, the source of recommendations to the President who, alone, can enact a safeguard remedy. Consequently, there is no adjustment plan. The trade union, even were it to have one (and it does not), could not implement a plan because only the manufacturers could do so. The Union's legal counsel did not think one was required, interpreting the special safeguard as more of a measure to deal with China's transition than as a transitional measure for impacted industries.

Notwithstanding the theory that the special safeguard was intended to stop Chinese exports, and nothing more, an adjustment plan is the key to the very concept of a safeguard, Section 421 does not formally require one, and none has been introduced in the tires case. Still, the ITC seemed to recognize that a safeguard remedy made no sense without one, and so the ITC majority imputed an adjustment plan to an industry ("the imposition of higher duties will increase prices and permit U.S. producers to utilize their available capacity to increase production, sales, and employment") that publicly has no intention of implementing it.

A telling example contrasting Sections 201 and 421 is the safeguard imposed for three years on wheat gluten. *Proclamation 7103 of May 30, 1998, To Facilitate Positive Adjustment to Competition from Imports of Wheat Gluten*. Notwithstanding that the domestic industry was being pounded by a surge in wheat gluten from Europe because of a sudden expansion there in the production of wheat starch (for which wheat gluten is a co-product from wheat flour), the domestic wheat gluten industry had to develop a plan, put it on a schedule, and demonstrate its progress periodically, both for initial application of a safeguard, and for its continuation throughout the three years of a numerical quota granted by the President.

The wheat gluten plan was to transition the industry from the production of wheat gluten for bread to the production of higher value and different goods. The industry developed, for example, environmentally-friendly biodegradable tent pegs and golf tees made from wheat gluten, as well as foods such as hot dogs and pancakes. Industry representatives presented the new products, sometimes with cooking demonstrations, to officials at USTR, the United States Department of Agriculture, and other interested federal agencies in order to convince them that the adjustment plan was real and viable. President Clinton would not have signed any safeguard proclamation, let alone three (including annual renewals) for a safeguard on wheat gluten, but for the adjustment plan.

President Obama is being asked, in the tires case, to provide relief against an import surge of commercial tires from China to an industry that is not asking for any, on behalf of a trade union that, had it an adjustment plan (which it does not), it could not implement. Although Section 421 does not require a plan, the legal question before President Obama is whether Section 421 can make any sense – whether it has an object and purpose – independent of a remedy that, without an adjustment plan, can provide no more than temporary relief, and perhaps no relief at all.

The union wants employment to manufacture tires. According to its economic consultants in the case, "the primary benefits of the remedy would be associated with the prevention of the closure of additional U.S. tire plants and the loss of still greater numbers of

jobs in that industry." The companies, however, do not want to manufacture the kind of tires for which the union members were once employed, and therefore will not keep open the plants that manufacture the tires in question. A remedy that reduces or curtails imports from China of commercial tires cannot, therefore, lead to long-term relief for the trade union, nor the domestic industry. Under Section 201, despite the broad discretion to provide relief conferred upon the President, he could provide no relief in the absence of an adjustment plan. Under Section 421, arguably he could, but he would violate the unstated object and purpose of Section 421 that, in its previous incarnation as Section 406 (for non-WTO communist countries), required remedies that would facilitate adjustment.

<u>The Political Dilemma Of The Tires Case</u>

Trade unions played an important role in the election of President Obama. The AFL-CIO, the nation's largest umbrella organization of unions, mounted on his behalf what it called its "largest, broadest and most targeted effort in AFL-CIO history," deploying 250,000 volunteers to reach out to 13 million voters in 24 states. A survey conducted on behalf of the AFL-CIO showed that Obama won among white male union members by 18 percentage points, while losing non-union white males by 16 points.

Seven months into his Administration, President Obama's popularity remains well ahead of the popularity of his recent predecessors seven months into their respective Administrations, but polls show his popularity slipping and he is headed into an autumn that promises brutal political combat over his highest domestic priority, reform of the crippled American health care system. He must be ever-mindful that the trade unions are an important part of his political base.

Many of the President's harshest congressional critics on health care are also vocal critics of trade with China. Eight of the ten Senators writing the President urging the safeguard remedy are Democrats whose support he must have on health care; seventeen "Blue Dog Democrats" (generally conservative Democrats from highly contested districts) resisting health care reform also have voted for legislation based on the conclusion that China unlawfully manipulates its currency, a bellwether of anti-China sentiment in the House of Representatives. The President likely cannot win health care reform without them. He must decide what to do about China and tires by September 17, shortly before the looming showdown on health care later in the autumn. He neither will want nor need to be indebted to his health critics because of something he may not do to China.

President Obama is also saddled with campaign promises, specifically to treat Section 421 differently from the way it was treated by President Bush who, invoking the law's provision to protect "the national economic interest," declined to implement any of the five safeguard actions against Chinese goods recommended by the ITC (in a sixth case, the ITC did not find "market disruption"). Candidate Obama joined the chorus questioning the trade deficit with China, and insisted he would be, as President, a champion of more rigorous trade law enforcement. His Treasury Secretary-designate, during his confirmation hearings in January, volunteered that China was manipulating its currency for trade advantages. Secretary Geithner's retreat from this position, apparently upon White House instruction, added to the pressure on the Obama Administration not to be "soft" on China.

The ten United States Senators who urged the President on July 17 to implement in full the ITC recommendations restricting Chinese tire imports, which many believe to be a prohibitive tariff, sought to impress upon the President that he must decide here "an important

test case," whether to activate Section 421 by imposing a safeguard on Chinese goods. It is also a test to side with trade unions against companies that openly are exporting manufacturing jobs by pursuing a global strategy that limits more expensive American production to higher value goods. Candidate Obama frequently decried the export of manufacturing jobs, and President Obama promised when signing the American Recovery and Relief Act, the $789 billion stimulus package, that "we're putting Americans to work doing the work that America needs done."

These factors – the Bush legacy; the trade union petition; the structure of political priorities; the campaign promises; the stimulus package; the offshoring of manufacturing jobs – all point politically to the adoption of some dimension of the ITC's safeguard recommendation. However, there are two sides to this scale.

On the other side of the balance, President Obama has declared himself repeatedly for free trade. He has emphasized a concern not to send protectionist signals to other countries. He recognizes the delicacy and importance of relations with China, and he has heard Chinese unhappiness about the possible imposition of a safeguard. On the American side some have claimed as many as 30,000 jobs at stake (about which much legitimate doubt has been cast); the conservative number on the Chinese side is 100,000. President Obama seems to understand that the domestic challenge for him is also a domestic challenge for Chinese leadership. As he seeks to partner with China on the road out of the global economic crisis, he does not want to make governance and management more difficult for Chinese leaders.

<u>China's Dangerous Litigation Strategy</u>

China has made a number of strategic choices in arguing the tires case, but two are more apparent than others. First, the Chinese side (the China Chamber of Commerce of Metals, Minerals and Chemical Importers and Exporters; and the China Rubber Industry Association, supported foremost by their principal U.S. customers, organized for purposes of the case into the "American Coalition for Free Trade in Tires") chose to emphasize economics rather than law. Rather than relying on legal references, statutory interpretation, negotiating history, or precedent, their arguments rely primarily on the economic analysis of a hired consultant. At the public hearing before the TPSC, they invoked the law almost not at all.

Much of the economic analysis, whether right or wrong, depended upon a sharp criticism of the economic analysis of the ITC. This approach underestimated the legal authority of the ITC, which is owed considerable deference for its economic analysis. It also underestimated the politics involved, as the ITC majority was led by prominent officials from the President's own political party.

Second, the Chinese side argued a quintessentially "Republican" position, urging the Obama Administration to accept the choices of the U.S. tire manufacturers to close plants and offshore jobs as part of a global cost efficiency strategy that reduces manufacturing employment in the United States. This argument may have resonated during the Bush Administration, but in the two-party system that defines American politics, those loyal to this philosophy, the one the Chinese side chose to trumpet, lost the election and, with it, their authority and legitimacy to manage the economy and protect jobs. Their attempt to instruct the President on how to protect jobs is especially hollow in the economic crisis that most Americans believe they helped create. Consequently, the political argument accompanying the economic

analysis is unlikely to resonate with the President, and may have the unintended effect of strengthening the union's position.

The combination of economic and political argument, and the failure to advance arguments based on interpretation of the statutory authorities and case precedents, gives President Obama no help in deciding this case on behalf of Chinese interests. President Obama is an excellent lawyer and respected professor of constitutional law. He is susceptible to strong legal argument. Were he of a mind to deny the safeguard remedy recommended by the ITC -- for reasons of national economic interest, or relations with China, or the futility of the proposed remedies -- he would need, and would appreciate, a strong legal argument upon which he could rely.

The Likely Outcome

President Obama's economics advisers, who will review the recommendations from the ITC, USTR, and the other participating agencies (Treasury, State, Labor, and Commerce), will have no difficulty recognizing that the U.S. tire manufacturers cannot be coerced to reopen closed factories, cannot be enticed to keep open factories slated for closure, and that a reduction in imports of Chinese tires surely will lead to an increase in imports from other countries who already have substantial market shares in the United States. Hence, they will understand that no remedy will produce the outcome sought by the United Steelworkers and recommended by the ITC.

The President's advisers will also understand, and surely recommend, that he must do something for the Steelworkers. He cannot appear to turn his back on the union; he cannot mimic George Bush by invoking the national economic interest, pressed incessantly at the public hearing by those testifying against a remedy, thus appearing to take sides against the union as to what, exactly, is in the national economic interest. He cannot appear to abandon his campaign promise about Section 421, nor appear to condone offshoring of jobs, especially to China. They will recommend, therefore, that he institute a remedy for the market disruption found according to the statute by the ITC.

The President will recognize that he does not want to act in a manner that will raise prices for consumers through a new market disruption, nor shut out from the U.S. market an important Chinese product, inviting international derision as a protectionist and Chinese dismay over what will appear, to Chinese authorities, as an act of bad faith. Consequently, the remedy he will choose likely will not be as drastic as the ITC's recommendation.

This outcome was not preordained. Had the Chinese case been built on law, President Obama, with appropriate expressions of sympathy and remorse, may have had the political courage to deny a remedy. He might have said that he recognized the injustice of the situation, agreed with the Steelworkers' complaint, but could provide no remedy because the object and purpose of the statute is to institute a remedy that will lead to an improvement for the industry, and there is in this case no plan for improvement. He would have had a legal peg upon which to hang a battered but rugged hat. Instead, with no law upon which to rely, the politics and economics upon which the Chinese side chose to depend will likely decide the matter.

Not Over Until It's Over: A Dilemma For China

China in 2009 wants recognition as a market economy. When Section 421 was written in 2000, China accepted recognition as a non-market economy. Section 421(j)(1) provides, "The Trade Representative is authorized to enter into agreements for the People's Republic of China to take such action as necessary to prevent or remedy market disruption." The statute suggests that such agreements be entered within a sixty-day consultation period that is about to expire (the affirmative determination of market disruption was made on June 18, making the deadline for a deal August 17). For China to enter an agreement restricting its trade, China implicitly would concede that the assumptions underlying Section 421, that China is a command economy, continue to be true.

There are mechanisms for market economies to control exports. Canada governs a quota and imposes an export tax on softwood lumber exports to the United States under a bilateral agreement that probably violates the WTO, but no country has complained and no one suggests that Canada is a non-market economy. China's Protocol of Accession to the WTO expressly provides for China to control exports, but mostly because the WTO treated China upon accession as a non-market economy.

China could forgo a settlement and bet the President will not provide import relief, but such a bet would be better placed in Macao than in Washington. Alternatively, China could seek an agreement, but doing so would acknowledge, at least implicitly, that China is still a non-market economy. An agreement, nevertheless, would be more promising for saving jobs in China and keeping Chinese tires in the American market than the ITC's proposed remedy, and might also be more palatable than the relief the President could, lawfully, impose under the terms of Section 421. Even were a remedy arguably unlawful because it would not facilitate an industry adjustment, there is no provision for an appeal of the President's decision.

Section 201 requires periodic review of safeguard remedies, above all to assure that adjustment plans are being implemented and that the domestic industry is doing its share to reduce long-term market disruption. As Section 421 has no express adjustment plan requirement, it also has no fixed requirement for periodic review. Nevertheless, after six months, the President may request that the ITC consider the probable effects of possible modifications, reductions, or terminations of relief, a report the ITC is expected by statute to deliver within 60 days of the President's request. The President may then modify, reduce, or terminate relief.

Chinese and supporting interests in the August 7 hearing warned that there would be much greater market disruption from the ITC remedy, or anything like it, than if no action were taken. All seemed to think the domestic tire industry would be more harmed than helped by contemplated trade restrictions. The industry might, therefore, seek a change in or termination of relief, beginning as early as March 2010.

Opponents of a remedy, then, provided the domestic industry joins them, may have another chance, only six months from September, to seek abandonment or change. President Bush famously implemented safeguards on steel products, and famously gave them up under pressure from trading partners, the WTO, and domestic consumers of raw steel, principally downstream manufacturers. Opponents in this case will want to continue to press for free trade. However severe the initial remedy may be, it may turn out to be very temporary. It will depend on whether the domestic industry will take on its union, and whether political and

economic forces that gather on the subject are as forceful and persuasive in arguing the law as the opponents of the steel safeguards turned out to be.

Dr. Feldman was lead counsel for Manildra Milling Corporation in the Section 201 safeguard proceedings on wheat gluten discussed in this article.