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UNDERSTANDING THE TRADE WAR

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Legal Briefings – By **Eric White, Consultant, Lode Van Den Hende, Partner and Morris Schonberg, Senior associate**

In this briefing we examine the foundations of the recent spate of unconventional US trade actions and the reactions thereto, which, if not already at war, look set to turn into one. We describe the US legal basis for this action, discuss the recent US measures themselves and examine their legality from a WTO law point of view. We also review the international reactions to these measures and comment on the WTO implications.

1. THE BASES FOR PROTECTIVE TRADE MEASURES IN US LAW

US law provides numerous bases for the imposition of tariffs and quotas on imports. First, there are the well-known remedies of antidumping and countervailing duties. These are measures directed at specific products from specific countries that are regarded as "unfairly traded" because these products are sold in the US at prices below their "normal value" (dumped) or with the benefit of subsidies respectively and in both cases cause injury to US industries. These measures are the subject of detailed rules and procedures in the US that are designed to respect well-established WTO agreements. That does not stop them being regularly the subject of WTO disputes.

Second, there is also provision in US law for action to be taken against imports from all countries of specific products that are not "unfairly traded" but still cause injury to US industry. Such measures are termed safeguard measures and are also subject to a WTO agreement regulating their use but this is less detailed. This is the basis on which the administration of George W Bush imposed protective measures on the import of a wide range of steel products during an earlier steel crisis in 2002. The EU, together with an alliance of 7 other WTO members successfully brought a WTO dispute settlement case against that measure. The dispute was adjudicated within 18 months and the measures were withdrawn by the US under threat of WTO sanctioned trade retaliation from the EU and others.

Third, there are other provisions of US law that provide for trade measures but are not provided for, or at least not regulated, at WTO level. One is Section 232 of the US Trade Expansion Act of 1962 that authorises the Secretary of Commerce to conduct comprehensive investigations to determine the effects of imports of any article on the national security of the United States. This is the basis for the US investigation and action against imports of steel and aluminium and the pending investigation into imports of automobiles and their parts. Another is the general purpose authority to conduct trade investigations and impose measures contained in Section 301-310 of the Trade Act 1974. This is the basis for the investigation in to China's intellectual property practices and the resulting measures specifically against China. It is these "unconventional measures" and their status under the WTO that we examine in this briefing.

2. THE US MEASURES

ACTION UNDER THE SECTION 232 OF THE TRADE EXPANSION ACT OF 1962

As described in our earlier e-bulletin Section 232 of the Trade Expansion Act of 1962 was used as a basis for investigations into the national security implications of imports of steel and aluminium. These reports concluded that action should be taken in each case and included alternative sets of recommendations aimed at restoring US capacity utilisation to acceptable levels. One set of recommendations was based on tariffs and the other on quotas. The reports included no consideration of whether these measures would be consistent with the WTO obligations of the United States.

On 8 March, US President Trump signed proclamations imposing duties of 25% on steel and 10% on aluminium imports which have been adjusted several times since to exempt and un-exempt various countries from the measures. Details of the current state of the measures can be found here.

Statements made and action taken at the time of the proclamations and subsequently reveal a broader trade or even protectionist purpose behind these measures. First, the press statements of the US President frequently refer to the action as favouring US industry and jobs or refer to trade imbalances with other countries. Second, imports from various countries have been the subject of exemptions and these exemptions have been removed or allowed to expire for trade related reasons. Canada and Mexico were exempted in order to encourage progress in the NAFTA negotiations. Although, this was officially expressed as providing an opportunity to elaborate an alternative solution to the national security concerns in the NAFTA negotiations, the reasons given for the expiry indicated a broader trade objective.

Imports from Korea were exempted on the basis that they were made subject to quotas set for each product at 70% of average 2015-2017 imports and further concessions granted to US trucks in Korea through an amendment to the Korea-US Free Trade Agreement.

Imports of steel from Brazil have been made subject to similar quota arrangements despite Brazil being one of the main sources of steel imports into the US. It has been reported that the reason for this was the fact that the Brazilian Government threatened to block the merger of Boeing and Embraer if it did not receive an exemption. Argentina seems to have been able to profit from a similar exemption arrangement.

Imports of steel and aluminium from the EU were exempted until 31 May 2018 while negotiations took place. The US objective was apparently to secure a reduction of certain tariffs, in particular on automobiles from the EU. However, the EU refused to negotiate "with a gun to its head". It was however prepared to accept quotas but insisted on favourable terms (maintaining 2017 levels). The US wanted a reduction of 30% from average 2015-2017 imports (similar to Brazil) and so negotiations failed and the exemption was allowed to expire.

Australia, alone among all countries of the world, appears to have a permanent and unconditional exemption as a result of lobbying by, among others, a golfing friend of President Trump. The Presidential Proclamation states that "alternative measures" have been agreed with Australia as well but, in contrast to all other exempted countries, no details are given as to what these might be in the case of Australia. Even least developed countries that are normally afforded tariff free access to the US market (and can legally be exempted from safeguard measures under the WTO) are subject to the duties.

On 23 May 2018, the US Department of Commerce (DOC) launched a second Section 232 investigation into the national security implications of automobile imports. According to DOC the investigation will “determine whether imports of automobiles, including SUVs, vans, light trucks, and automotive parts into the United States threaten to impair the national security.” President Trump has reportedly asked for additional tariffs of as much as 25% on automobile imports, though this is not reflected in any official documents. The procedure is ongoing and the period for submitting comments was open until 22 June 2018 and will be followed by rebuttals and hearings in July. The report should be submitted within 270 days, that is, before early 2019.

The WTO justification for Section 232 action

Action under Section 232 is unprecedented and unconventional but is claimed by the US to be legal under the WTO Agreement. The United States relies on the "national security exception" in Article XXI GATT. This provides, in its paragraph (b), that
"Nothing in this Agreement shall be construed … to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests

- relating to fissionable materials or the materials from which they are derived;
- relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment;
- taken in time of war or other emergency in international relations."

The justification advanced is that steel and aluminium are goods and materials required (indirectly) for the purpose of supplying its military and that US capacity in these sectors is therefore necessary for national security. The US does not appear to be relying on the existence of a war or other emergency.

While the traditional US view has been that this provision is "self-judging" and its invocation is not subject to dispute settlement, the EU view, at least since the conclusion of the WTO Agreement with a generally-applicable and binding dispute settlement mechanism, has been that any action taken on the basis of the provision must be justified in accordance with its terms. The two already crossed swords on the matter in the Helms Burton dispute back in 1996.

While a WTO dispute settlement case is likely to be brought by a number of countries, the prospect of a speedy solution is less promising than in 2002 because the United States is currently blocking the appointment of new Members of the WTO Appellate Body and is thereby impeding the functioning of the dispute settlement system.

ACTION UNDER SECTION 301 OF THE TRADE ACT OF 1974

Section 301 of the Trade Act of 1974 is a more general provision allowing investigations into trade issues with a view to the taking of remedial action (including the initiation of dispute settlement action). The unilateral nature of the action became an issue in the Uruguay Round negotiations and its abolition an objective of the other parties.

The EU had earlier brought WTO dispute settlement proceedings against Section 301 in 1998 as inconsistent in particular with the obligation in Article 23 of the WTO Dispute Settlement Understanding (DSU) to resolve disputes exclusively through resort to the DSU. That case ended without the US being required to abolish this provision because of a US assurance delivered during the proceedings that it would not invoke Section 301 outside of WTO dispute settlement proceedings. In an unprecedented manner, the panel noted that its findings were based on this assurance. The panel stated therefore that should those undertakings be repudiated or in any other way removed, its findings of conformity would no longer be warranted.

As a result very few Section 301 investigations have been launched since the Uruguay Round. The only investigation that led to measures seems to have been one against Ukraine before it became a WTO Member. However, the Section 301 procedure has now been resuscitated. China has not been slow to point out that his action contradicts the adopted recommendations of the DSB.

On 14 August 2017, President Trump instructed USTR to investigate China's law, policies, practices, or actions that may be unreasonable or discriminatory and that may be harming American intellectual property rights, innovation, or technology development.

On 22 March 2018, the USTR produced its detailed report into a number of Chinese laws and practices and on 3 April it announced the initiation of WTO dispute settlement proceedings in relation to one aspect of the investigated measures and proposed the imposition $50 billion of trade sanctions against Chinese exports to the US. China responded by announcing that it would impose duties varying between 15 and 25 % on a list of US products. These were technically rebalancing measures responding to the US measures on steel and aluminium (they may be seen here) but the timing of their announcement as well as the political messaging made it clear that politically they were a response to the Section 301 sanctions.

President Trump immediately responded to what he termed this "unfair retaliation" by China by instructing USTR on 5 April to consider a further $100 billion of trade sanctions on Chinese trade. Subsequent statements from China indicate that it is matching US additional duties "dollar for dollar". Recently, in reaction to such an announcement from China, the bidding has been increased with an announcement by President Trump of preparation for a further $200 billion of trade sanctions. Because of the large deficit in US – China trade, China will eventually be unable to continue to match additional duties "dollar for dollar" and has suggested that it will resort to other retaliatory measures, for example against US investments in China.

The imposition of trade sanctions always requires careful consideration to ensure that they do not harm the imposing country more than the intended victim - not to mention the need to allow interest groups to express their views. Their level is also subject to careful calibration. The amount of the sanction is considered to be the value of trade covered multiplied by the percentage duty imposed. Accordingly, the amount of the sanction, the level of additional duty potentially collected and the volume of trade affected are very different matters which can give rise to confusion. The draft US list and invitation for comments covering some 1300 tariff lines was published on 3 April 2018 and can be found here.

For this reason, the imposition of the measures was not immediate on either side. Rather the period of preparation of additional duties was used, as was intended, to commence negotiations, which soon focussed on ways of reducing the trade deficit through increasing purchases of US commodities.

The US considered that the concessions offered by China were insufficient and on 15 June 2018 published a first list of 818 tariff lines on which additional duties would apply on Chinese imports as from 6 July 2018, and announced that interagency consultations were continuing on a second list covering a further 284 tariff lines.

There has been a gradual but constant increase in rhetoric and other measures become drawn into the dispute. This was the case of the measures imposed on the Chinese telecom company ZTE for violation of undertaking that it had given in relation to alleged violations of US export controls towards North Korea and Iran. These have been suspended following instructions from President Trump apparently in order to facilitate the broader negotiations and may be re-imposed following legislative action in Congress. In parallel, Chinese buyers have on 9 May apparently cancelled orders of American soybeans (a sensitive product from key US constituencies that is also on the Chinese threatened retaliation list). Similarly, it is reported that China has warned that the result of all trade talks between Beijing and Washington will be void if the US proceeds to implement trade sanctions.

3. THE INTERNATIONAL REACTION TO THE US MEASURES

While the European Union expresses sympathy for the US claims of forced technology transfer by China, has brought its own WTO case against China in this regard and more generally calls for the negotiations of new WTO disciplines on "state capitalism", it has been scathing in its condemnation of the measures taken by the US to protect its steel and aluminium industries. It contests that these measures are necessary or even intended to address a national security concern and has announced three actions in response to these measures:

- WTO dispute settlement action against the US Section 232 measures (here).
- Arguing that the US is in fact simply taking safeguard action without complying with the rules, it has prepared rebalancing action under Article 8 of the Safeguards Agreement. This is not retaliation but measures taken to maintain the balance of commitments in the WTO in the light of what is supposed to be emergency relief against "fair trade". In accordance with the Safeguards Agreement, some of these measures would apply rapidly while others would be deferred for 3 years.
- The initiation of (proper) safeguard proceedings by the European Union to ensure that excess steel that is diverted from the US market is not imported into the European Union

in such increased quantities as to cause serious injury to EU industry.

The European Union also requested an exemption from the US measures and suspended the initiation of dispute settlement proceedings and prepared to enter into constructive trade negotiations to meet US concerns so long as it was exempted.

Many other countries contest the national security justification for the US steel and aluminium measures and have taken similar action to the EU. China, India, Canada and Mexico as well as the EU have all initiated dispute settlement proceedings against the US. The same counties plus, the Republic of Korea, the Russian Federation, Turkey and Japan have also notified to the WTO rebalancing action against the US in the same way as the EU. However, only Turkey has notified the initiation of a safeguard investigation along with the EU.

Only China has brought a case at the WTO against the US Section 301 measures and no country has so far requested third party status.

The US (or at least its President) has started to threaten retaliation against the "rebalancing measures" in the form of a 20% tariff on EU exports of automobiles. If a trade war is defined as the taking of retaliatory action against retaliatory action, then the trade war has arguably started.

4. COMMENT ON IMPLICATIONS FOR THE WTO

The actions described in this note all pose challenges for the WTO. Two of its primary purposes are to provide disciplines on trade action and to provide a forum for resolving disputes and determining compensation and countermeasures. The kinds of trade measures that may be taken are exhaustively provided for in the covered agreements and the unilateral determination of the existence of a WTO violation is prohibited by Article 23 of the DSU. The measures and countermeasures described above may violate the WTO agreement in a number of ways:

- As noted above the US Section 232 measures are protectionist measures thinly disguised under a mantle of national security.
- While the WTO does not prohibit the use of instruments to investigate issues that are not covered by WTO disciplines (such as forced transfers or even "theft" of intellectual property), it does very clearly prohibit the imposition of duties on goods in excess of bindings (as well as discriminatory application of trade measures).
- The EU argument that the US Section 232 measures are in reality safeguard measures (adopted by many others) may be little more than a clever excuse for taking immediate

countermeasures and being able to pretend they are WTO-consistent. The US has never claimed to be taking safeguard action and has not notified its measures as safeguard measures and it is therefore not certain that the exceptional remedy of rebalancing in Article 8 of the Safeguards Agreement applies.

- If the US Section 232 measures are safeguard measures, then country specific exemptions of the kind sought by the EU, Canada, Mexico and others (and obtained by Australia, Korea, Brazil and Argentina) are a violation of Article 2.2 of the Safeguards Agreement which says that a safeguard measure are to be applied to a product being imported "irrespective of its source".

- In any event, the equal treatment of countries is fundamental to the WTO Agreement and it is therefore not just the trade measure that must be justified but also its discriminatory application. There does not appear to be any basis to argue that the high level of steel imports from some exempted countries do not pose a threat to national security and may exempted from duties while the low levels of imports from many others (including least-developed countries) do.

Unfortunately the WTO dispute settlement system is currently ill-equipped to deal with this crisis. The United States is currently blocking the appointment of new Members of the WTO dispute settlement body and impeding the functioning of the system.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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