Research

U.S. Trade Enforcement Mechanisms

DOUGLAS HOLTZ-EAKIN, JACQUELINE VARAS | FEBRUARY 14, 2018

Executive Summary

- Trade and other international economic agreements provide broad benefits to the United States and its international trade partners. However, these agreements must be enforced effectively to engender the trust needed to maintain and expand international commerce.
- The primary enforcement mechanisms are dispute settlement provisions under specific trade laws and the World Trade Organization, as well as anti-dumping and countervailing duties to counter harm from specific countries and products.
- “Safeguard actions” provide import restrictions to protect harmed domestic industries. An interesting test of safeguards are the recently imposed import restrictions on washing machines after Samsung and LG were perceived to have evaded U.S. antidumping duties by moving production from South Korea to China, Vietnam, and Thailand.
- Enforcement is also important in other forms of international agreements such as treaties. For example, a test of the future of the Open Skies treaties with Qatar and the United Arab Emirates is the ability to negotiate resolution of the damage to U.S. carriers from government-subsidized international routes by three airlines headquartered in those countries.

Introduction

International economic agreements contribute to the ability of the United States and its allies to build stronger relationships, accomplish shared goals, and reap the economic benefits. A key tool for preserving confidence in these agreements is enforcement mechanisms. Absent these features, agreements would not permit nations to fully experience the advantages of international commerce.

International trade creates significant benefits for the United States. It expands the consumer base and increases demand for U.S. businesses, exposes Americans to lower-priced or higher-quality consumer goods from around the globe, and generates significant productivity gains resulting from international competition and specialization. Trade agreements increase these benefits by reducing trade barriers. They also foster global trust, cooperation, and stabilization.

For trade agreements to be effective, all partners must have confidence that the terms will be upheld. Nations must be assured that their exports to partner countries will not be taxed at higher rates than previously agreed, that they will not face unfair competition from government-subsidized goods in other nations, and that no trade agreement partner will discriminate against them in favor of its own domestic producers. With this confidence intact, producers and consumers can trade freely and experience the economic growth that is spurred by open markets.

In cases where the United States (or another trade agreement partner) believes it is being treated unjustly, there must be a path to adjudicating the complaint. This is also true for other types of agreements in which nations are held accountable. The United States has established several such mechanisms for resolving these types of disputes.

Dispute Settlement

In the realm of trade agreements, there are two main types of dispute resolution mechanisms. The first is Investor-State Dispute Settlement (ISDS), a procedure in which investors can pursue arbitration with governments that discriminate against foreign suppliers. ISDS can also be triggered if governments deny foreign investors their right to due process, seize property without just compensation, or restrict the movement of capital within their borders. Approximately 3,000 agreements worldwide contain some type of ISDS provisions, and the United States is party to 50.

When an ISDS case is brought against a nation's government, it is not resolved through either nation's court system. Instead, the parties enter an arbitration process in which the case is decided by a three-member panel of legal experts. While some have criticized this process, it is designed this way to protect investors from potential bias within a country's courts and from weak legal institutions in developing nations. Furthermore, in the over 20 years in which the United States has been party to ISDS agreements, it has been sued by foreign investors only 16 times. Of those, 10 were decided in favor of the United States and the remaining cases were either settled or dropped. By contrast, U.S. investors have utilized ISDS to challenge foreign governments over 150 times.

ISDS gives companies at home and abroad the security to invest internationally. Without it, foreign and domestic businesses may not have the confidence to expand, participate in trade, or invest in the United States.

The second type of dispute resolution is State-to-State Dispute Settlement (SSDS). If nations have a dispute concerning the interpretation or application of an agreement, they can seek arbitration through SSDS. Like ISDS, trade partners can request the formation of a three-member arbitration panel of representatives from each nation to rule on disputes. The United States has only been involved in eight SSDS cases: five under the U.S.-Canada Free Trade Agreement and three under the North American Free Trade Agreement (NAFTA).

In addition to dispute settlement processes laid out in U.S. trade agreements, the World Trade Organization (WTO) also functions as a mechanism to enforce the rules of global trade. It was formed in 1995 to oversee the global trading system and promote the liberalization of trade barriers, and now has over 160 member nations. Members of the WTO face lower tariffs when exporting to other WTO nations and are afforded protections against unjust trade barriers and discrimination.

For nations that do not wish to utilize dispute settlement mechanisms within individual trade agreements, or for nations that do not have trade agreements with one another, the WTO offers its own dispute settlement procedure. The WTO dispute settlement process resembles that of an international tribunal: Countries engage in initial consultations, hearings, and the creation of a panel to aid in making rulings and recommendations, which are subject to appeal. Final decisions are adopted by the Dispute Settlement Body; a council consisting of representatives of all member governments. While the primary goal of this process is to settle disputes privately through initial consultations, the WTO has an average of 30 dispute settlement panels active each month. Decisions are usually made in a little over one year.

Anti-Dumping and Countervailing Duties

The United States can also try to unilaterally enforce trade rules by imposing anti-dumping and countervailing (AD/CV) duties. These are duties placed on imports that injure U.S. industry, either due to government subsidies or sales at below cost prices. U.S. businesses can petition the Department of Commerce and the U.S. International Trade Commission (USITC) to perform AD/CV investigations if they believe competing products from specific countries are injuring them. If the Department of Commerce finds dumping or subsidization and USITC finds material injury to U.S. industry, duties are applied to specific imports from that country to offset the subsidies or dumping.

It is not always necessary for domestic industry to petition for an investigation to take place. While it is rare, the Department of Commerce may self-initiate AD/CV investigations. This practice has occurred under the Trump Administration, which self-initiated an investigation against Chinese aluminum late last year. However, AD/CV duties may be met with backlash. Canada recently launched a WTO case against the United States for placing AD/CV duties on imports of softwood lumber, and initiated an SSDS process under NAFTA.

Additional Trade Enforcement Mechanisms

Legislation has empowered the United States to seek other enforcement options as well. For instance, the Trade Act of 1974 offers multiple avenues for the United States to challenge trade actions taken by other nations. One example is Section 201 – a statute that authorizes USITC to perform "safeguard investigations." If USITC finds that a recent surge of imports has seriously injured domestic producers (or there is a threat of serious injury), it can recommend temporary import restrictions. Unlike AD/CV duties, these restrictions would apply to all imports of a specific product, regardless of the country of origin. Furthermore, for USITC to recommend import restrictions following a safeguard investigation, it does not need to find that exporters were engaging in potentially illegal or uncompetitive activity (e.g. receiving government subsidies). It only needs to confirm that the import surge is causing serious injury (or a threat of serious injury) to domestic industry.

Under the Trump Administration, USITC has launched two safeguard investigations. One investigated imports of solar cells and modules , and the second concerned imports of large residential washing machines.

USITC first started investigating washing machine imports after Samsung and LG (both based in South Korea) evaded U.S. antidumping duties resulting from previous AD/CV investigations. Whirlpool alleges the companies moved production from South Korea to China, Vietnam, and Thailand after tariffs were enacted. USITC agreed with Whirlpool that these imports threaten domestic suppliers, and the president responded by enacting tariffs of 20 percent on the first 1.2 million units of washing machine imports. Tariffs on imports above this level will start at 50 percent, but both tariff rates will decline over time.

The other safeguard investigation was in response to increasing competition from solar imports. A U.S.-based manufacturer claimed that increasing solar imports from China, where solar companies are subsidized by the government, causes serious injury to domestic manufacturing. In this case, USITC also concluded that solar imports threaten domestic industry and the president imposed tariffs starting at 30 percent and declining over time.

Section 301 of the Trade Act of 1974 is another example. This statute empowers the U.S. Trade Representative (USTR) to investigate unfair trade practices, which can include trade agreement violations, market access restrictions, legal violations, or discriminatory practices. USTR recently initiated a Section 301 investigation into China for intellectual property theft and improper technology transfer, a practice that U.S. companies have been protesting for years. If USTR confirms these unfair trade practices, it has the authority to impose tariffs or other import restrictions on China. Or, if China agrees, they may also enter into a binding agreement to phase out the practice of intellectual property theft.

These tools enable the United States to enforce the rules of international trade while also protecting the U.S. from discrimination and trade cheating. However, it is important to balance any trade enforcement action pursued by the United States with the possibility of retaliation by other countries, effects on other domestic industries, and potential economic harm to consumers.

Some argue that legislation like the Trade Act of 1974 has become obsolete with the establishment of a multilateral trading regime and the creation of the WTO. They further argue that any action taken against our trade partners should only be pursued through the WTO, and that there is a credible threat of retaliation if the United States acts unilaterally. This is a serious risk: If our enforcement actions are met with trade restrictions from other countries, U.S. exporters could lose market access abroad and U.S. consumers will be faced with higher prices. Furthermore, it would be foolish to believe that trade restrictions imposed by the United States can revive uncompetitive industries or counteract natural shifts in production. However, it is necessary to enforce the rules of trade agreements after they are negotiated and agreed to. If rules are not enforced, unfair trade practices will go unchallenged and it will be difficult to maintain domestic support for trade agreements.

Enforcement in Other International Agreements

Effective enforcement is also important for instilling confidence in other types of international agreements. For instance, the State Department recently opened talks with Qatar (and plan to so with the United Arab Emirates) about an international agreement called Open Skies. This is one of over 120 U.S. bilateral agreements designed to prevent government intervention in commercial airline travel. Under Open Skies, private airlines in all partner nations have the freedom to make their own decisions about airline routes, the number of flights, the types of aircrafts, and pricing.

Before Open Skies, governments regulated all aspects of airline travel. The Airline Deregulation Act of 1978 deregulated the airline industry in the United States, making way for market forces to spur competition, innovation, and lower prices for consumers. The United States continued this trend in 1992 by establishing the first Open Skies agreement with the Netherlands. We have since entered into Open Skies agreements with partners around the globe in Europe, Africa, the Middle East, the Asia Pacific, and Latin America and the Caribbean.

Open Skies has produced significant benefits for both airline industries and consumers. According to the International Trade Administration (ITA), the U.S.-EU Open Skies Agreement was projected to increase the total number of airline passengers by up to 39 million and increase cargo by up to 170,000 tons. ITA argues that Open Skies also enabled a growth in international trade by improving supply chain efficiency and reducing the distance between manufacturers, suppliers, and customers. Another study found that liberalizing the air services of 320 countries without a current Open Skies agreement would create 24.1 million full time jobs and boost the global economy by $490 billion.

The United States opened diplomatic channels with Qatar (and plans to do so with the United Arab Emirates) after American, Delta, and United Airlines alleged that government subsidies to state-owned Gulf airlines are forcing competitors out of the market. Specifically, they claim that these subsidies are in violation of Open

Skies’ Fair Competition Clause, in which all airlines are allowed a “fair and equal” opportunity to compete. According to the airlines, the governments of Qatar and the United Arab Emirates (UAE) have given over $52 billion in subsidies to Qatar Airways, Etihad Airways, and Emirates.

The current Open Skies dispute is a pertinent example of how enforcement is integral to the success of international agreements. Due to foreign subsidies, U.S. airlines have been forced to terminate their competing routes to Gulf nations.. Without enforcement, airlines in Qatar and the UAE would continue benefitting from these subsidies and driving U.S. competitors out of the market. This is evidenced by the fact that over 80 percent of Gulf Carrier flights to the United States in 2014 were found to be unprofitable. These carriers are willing to operate at a loss in order to capture market share.

The addition of “fifth freedom” flights – flights by an airline between two foreign countries – appears to be another byproduct of Gulf subsidies. In the case of the UAE, Emirates has started offering fifth freedom flights in the U.S.-EU market targeted to consumers not flying to the Gulf. For example, they offer nonstop flights between New York City and Milan as well as between Athens and Newark. By leveraging government subsidies and continuing to add fifth freedom routes, Gulf airlines could conceivably overtake the United States as the global leader in aviation, significantly diminishing the economic prospects of U.S. carriers.

As a result of diplomatic talks, Qatar airways has agreed to commit to greater financial transparency and to halt any fifth freedom flights to the United States. This is an important first step toward ensuring that entities which use government subsidies are held accountable and that competition between the United States and Qatar remains open.

Conclusion

International commerce and cooperation have immense benefits for the United States. Entering into international agreements with other nations is one of the best ways we can build relationships with our allies. However, effective enforcement of these agreements is a key component of their success. To fully benefit from the economic growth that follows open markets or international deregulation, nations must have confidence in the agreements themselves.