



International Trade & Regulatory ADVISORY ■

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Previewing Trade Policy in the Trump Administration

Part 2: China

Throughout Donald Trump's campaign, a prominent theme was the candidate's willingness to address perceived shortcomings in the United States' trade policies and dealings with foreign countries. These reforms, should they come to pass, would have significant impact on U.S. trade relations and are likely to invite legal challenges at the World Trade Organization (WTO) and under other agreements. For companies engaged in international trade activities, Trump's proposals have the potential to disrupt global supply chains, investment decisions and business operations in multiple markets.

He also threatened new tariffs against China and, if necessary, withdrawal from the WTO if China did not agree.

In the second of a three-part series, we analyze the Trump Administration's potential China policy. [Part 1](#) explored current trade agreements. Part 3 will discuss sanctions regimes on Iran, Cuba and Russia.

Currency Manipulation

Trump has pledged to act within his first 100 days in office to "instruct the Treasury Secretary to label China a currency manipulator." Currently, executive authority regarding currency manipulation is governed by the Trade Facilitation and Trade Enforcement Act of 2015 (TFTEA), which introduced new "intensified evaluation provisions" to the currency policies of major U.S. trading partners.

The TFTEA reformed reporting and analysis requirements of the Omnibus Trade and Competitiveness Act of 1988. The 1988 Act mandated an annual analysis by Treasury, in consultation with the International Monetary Fund (IMF), to "consider whether countries manipulate the rate of exchange between their currency and the United States dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade."

The TFTEA reforms now require that Treasury undertake an enhanced analysis of exchange rates and externally oriented policies for each major trading partner that has: (1) a significant bilateral trade surplus with the U.S.; (2) a material current account surplus; and (3) engaged in persistent one-sided intervention in the foreign exchange market.

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Treasury has created a “Monitoring List” of major trading partners that merit attention based on an analysis of the three criteria. Specifically, an economy is added to the Monitoring List when it meets two of the three criteria. Once added, an economy will remain on the Monitoring List for at least two consecutive reports to help ensure that any improvements in performance versus the criteria are durable, not due to temporary one-off factors. Six major trading partners of the U.S. are included on the Monitoring List in the most recent report: China, Japan, South Korea, Taiwan, Germany and Switzerland. *Critically, in the biannual reports since the TFTEA became law, Treasury has found that no trading partner has met all three criteria specified in law.*

Treasury has determined the following thresholds for the three criteria for enhanced analysis specified in the TFTEA: (1) a significant bilateral trade surplus with the U.S. larger than \$20 billion; (2) a material current account surplus larger than 3 percent of GDP; and (3) persistent, one-sided intervention, including net purchases of foreign currency, conducted repeatedly, totaling more than 2 percent of an economy’s GDP over a 12-month period. Again, no economy has yet satisfied all three criteria.

In its October 2016 report, the Treasury noted that U.S. financial diplomacy has secured important commitments in recent years regarding exchange rate policy from G-7 and G-20 members. In particular, the G-7 has committed to orient fiscal and monetary policies toward domestic objectives using domestic instruments and to not target exchange rates. The G-20 has committed to refrain from competitive devaluations and to not target exchange rates for competitive purposes. This year, G-20 members also agreed to consult closely on exchange markets—an important component of G-7 communiqués in the past, but never before included as a G-20 commitment. Further, the IMF has improved the exchange rate analysis in its bilateral and multilateral reports, and Treasury is working with the IMF to further strengthen this analysis.

The TFTEA also mandates that the President create an Advisory Committee on International Exchange Rate Policy to provide advice to the Secretary of the Treasury on the impact of international exchange rates and financial policies on the economy of the U.S. Pursuant to the TFTEA, the Advisory Committee will be composed of nine members, with three appointed by the President, three by the president pro tempore of the Senate and three by the Speaker of the House. Treasury has filed a charter for the Advisory Committee in accordance with the Federal Advisory Committee Act.

The TFTEA does not provide the President with direct authority to label a country as a “currency manipulator” absent a finding via the Treasury, nor does it authorize the imposition of tariffs or taxes as a remedy if such a finding is made. Instead, following a finding by Treasury of manipulation that confers an unfair trade advantage, the TFTEA instructs the Treasury to consult in “enhanced bilateral engagement” with a country to seek changes to relevant economic policies and eliminate currency undervaluation. After a year of such engagement, if the Treasury finds that consultations have failed to resolve the undervaluation, then the Act authorizes the President to take one or more of the following measures:

- (A) Prohibit the Overseas Private Insurance Corporation from approving any new financing [for projects in the named country].
- (B) ... Prohibit the Federal Government from procuring, or entering into any contract for the procurement of, goods or services from that country....

- (C) Instruct the United States Executive Director of the [IMF] to call for additional rigorous surveillance of the macroeconomic and exchange rate policies of that country and, as appropriate, formal consultations on findings of currency manipulation.
- (D) Instruct the United States Trade Representative to take into account, in consultation with the Secretary, in assessing whether to enter into a bilateral or regional trade agreement with that country or to initiate or participate in negotiations with respect to a bilateral or regional trade agreement with that country, the extent to which that country has failed to adopt appropriate policies to correct the undervaluation and surpluses....

Essentially, this provision would bar the inclusion of the country in a U.S. free trade agreement negotiation.

The limited authority in the TFTEA reduces the flexibility of the incoming Trump Administration regarding Chinese currency policy. The next report on currency policies of major trading partners by the Treasury is due in April 2017. We anticipate that the Advisory Committee and Congress may seek to pressure Treasury's international economic staff regarding their findings, but the legal criteria are clear. Additionally, current global macro trends indicate that major economies, including China, have throughout 2016 been seeking to prevent *depreciation* of their currencies, and such efforts would not lend themselves to a finding of currency manipulation that favors exports.

Chinese currency policy, however, remains an issue that has bipartisan support in Congress for greater U.S. action. Democratic Senators Chuck Schumer (NY) and Debbie Stabenow (MI) are among the most vocal critics of Chinese currency policy, and this issue could provide one potential common ground between congressional Democrats and the Trump Administration. Separate from Treasury actions, we also anticipate the use of the private right of action under Section 301 of the Trade Act of 1974 by aggrieved U.S. industries, particularly steel, to seek an investigation by the U.S. Trade Representative (USTR) on the subsidy effect of Chinese currency.

WTO Cases and Other Legal Action Against China

Trump has pledged to "instruct the U.S. Trade Representative to bring trade cases against China, both in this country and at the WTO." Trump's campaign platform alleged that "China's unfair subsidy behavior is prohibited by the terms of its entrance to the WTO."

The Obama Administration filed 14 WTO disputes against Chinese trade practices from 2009 to 2016, and the USTR's enforcement staff and office of general counsel are well-positioned to initiate new cases, provided there is substantial industry support and participation in the lengthy processes involved with bringing such high-level disputes. We anticipate that the Trump Administration will consider filing cases regarding state support for Chinese steel producers as well as China's use of its antimonopoly law as leverage in IP licensing disputes between Chinese companies and U.S. patent holders. Such cases remain highly dependent on the willingness of U.S. companies to provide proprietary information and endure exposure to possible retaliation in the Chinese market.

Trump has also stated that he would “use every lawful presidential power to remedy trade disputes if China does not stop its illegal activities, including its theft of American trade secrets—including the application of tariffs consistent with Section[s] 201 and 301 of the Trade Act of 1974 and Section 232 of the Trade Expansion Act of 1962.”

Section 301 of Chapter 1 of Title III of the Trade Act of 1974 concerns investigations by the Office of the USTR into allegations that foreign countries are denying benefits to the U.S. under trade agreements or are otherwise engaged in unjustifiable, unreasonable or discriminatory acts that burden or restrict U.S. commerce. In general, the USTR may initiate investigations upon petition by any interested person or upon its own initiative. The key question at the outset of the Trump Administration will concern the likelihood that the new USTR will self-initiate such investigations regarding either the provision of state subsidies in Chinese industry or the denial of market access to various U.S. industries that may violate China’s WTO obligations.

Section 301 does authorize retaliatory actions, including retaliatory tariffs in the same amount as damages suffered by U.S. industry from the actions of a foreign trading partner. The relationship between Section 301 and the WTO is critical to determinations of action since the WTO has ruled that discriminatory actions that do not follow from an authorization provided by a WTO dispute ruling are in violation of the WTO agreements. Nevertheless, the Trump Administration could pursue action following a USTR investigation and consultation with Congress that could erect tariffs on Chinese imports for the duration of a Chinese legal challenge of those actions at the WTO.

Under Section 232 of the Trade Expansion Act of 1962, the Secretary of Commerce conducts investigations to determine whether articles are being imported into the U.S. in such quantities or under such circumstances as to threaten to impair national security. On the basis of a report by the secretary, the President has authority to take action to “adjust the imports” of the article in question. Conceivably, such adjustments may include the imposition of temporary duties, quotas, tariff rate quotas or outright importation prohibitions. Use of a Section 232 action by the Trump Administration would likely engender a WTO challenge centered on the national security exemption of the GATT (Article XXI), which has never been the subject of a WTO dispute.

China Nonmarket Economy Status

Regardless of the December deadline for WTO members to recognize China as a market economy for the purpose of trade remedy investigations, the Trump Administration will likely continue U.S. policy treating all Chinese trade remedy matters on a case-by-case basis and deny market economy status generally to the Chinese economy.

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