

United States-China Trade Litigation in the WTO

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The two most intriguing aspects of today's global trading system are the convergence of the role of the World Trade Organization (WTO) litigation and United States-China bilateral trade relations.¹ The U.S. has made WTO litigation a major component of its trade policy of "active engagement" to meet the new challenges of East Asia.² A response to the historic change of control within the Congress at the 2006 mid-term elections, the policy has become a central aspect of U.S.-China trade policy.

The U.S. government has initiated a trade offensive against China in the WTO, mainly in response to the shift of congressional control from the Republican Party to the Democratic Party. This offensive has serious implications beyond the bilateral trade issues concerning the U.S. and China. It foreshadows the governance of global trade moving from negotiations toward more litigation.

This change and its effects raise two broader questions. First, what are the implications of this U.S. trade offensive against China for global trade relations? Second, is resorting to WTO litigation a default position because of the failure of international negotiations?

My approach is to focus primarily on recent WTO litigation involving the U.S. and China while noting recent international negotiations and pending Congressional legislation.

WTO Litigation

Since the midterm elections, the United States has launched an assault on China using WTO litigation. In 2007, the United States filed three cases in the WTO against China.

The first case, filed on February 2, 2007, targeted a range of export subsidies. (*Exemption from Taxes as to Domestically Produced Goods*)³ The U.S. contends that China is violating the Subsidies Agreement and National Treatment Principle. Specifically, the U.S. argues that China provides various tax rebates to a range of Chinese firms amounting to export subsidies.⁴ Mexico filed a similar case and a panel was established in September 2007.⁵ The U.S. case was suspended in November after the parties reached a settlement.

On April 10, 2007, the United States filed twin cases.⁶ The first of these cases involved an alleged failure to enforce intellectual property rights. (*Protection & Enforcement of Intellectual Property Rights*)⁷ The U.S. alleges that China is violating the Intellectual Property Agreement (Trade-Related Aspects of Intellectual Property Rights, or TRIPS) by not enforcing its intellectual property obligations. For example, the U.S. argued that the threshold to establish trademark counterfeiting and copyright piracy under China's criminal procedures is too high. Moreover, the U.S. argues there is a lack of procedures and penalties. A panel to determine

this matter was established in September 2007.

The second of these cases targeted market access and distribution restrictions on films and audiovisual products. (*Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*)⁸ The U.S. argues that China maintains restrictions on the import of films and restricts foreign companies from distributing films and DVDs. The U.S. contends these restrictions violate market access obligations under the 1994 General Agreement on Tariffs and Trade (GATT) as to imports, as well as the Services Agreement concerning domestic distribution. A panel was requested in October 2007.

Neither of these cases had third parties joining the U.S. Apparently, no foreign governments wanted to be associated with either the merits of the cases or their timing, given their foreign policy or other global trade considerations.

Prior to the 2007 WTO litigation, the U.S. filed two WTO cases against China. The earlier filings indicate that the U.S. began choosing WTO litigation against China as an important trade tool several years prior to its most recent actions.

The first case, filed on March 18, 2004, (*VAT & Integrated Circuits*),⁹ was settled in the consultation stage by a “mutually agreed-upon solution” prior to full litigation.¹⁰ The U.S. contended that China was violating the National Treatment Principle of the GATT, and argued that the refund of

the value added tax to Chinese manufacturers (or when Chinese designed chips were imported) violated the GATT. The second case, filed on March 30, 2006, (*Imports of Auto Parts*)¹¹ had the U.S. and the European Union arguing that the import of auto parts are subject to tariffs equal to those on completed cars.¹² They argued that they should be charged the lower rate for parts, rather than the higher rate, for completed automobiles and that failure to classify the parts properly violates the GATT and the Trade-Related Investment Measures Agreement. A panel has been requested.¹³

While not currently involving WTO litigation, a U.S. Court of International Trade decision of 2007 (*High-Gloss Paper/NewPage Corporation*) further complicates the trade disputes between China and the United States. China has recently threatened to bring full litigation against the U.S. in the WTO concerning subsidies levied pursuant to this case.¹⁴ This case marks the first by China as a sole complainant.¹⁵ Consultations were requested in September.¹⁶ On March 29, 2007, the U.S. Court of International Trade in New York upheld the George W. Bush administration’s (Department of Commerce) change of trade policy, bringing subsidy actions against Chinese imports.¹⁷ The administration decided as a matter of policy to allow subsidy actions concerning goods from non-market economies. This ruling reversed the 1980’s *Georgetown Steel* and U.S. trade policy of the last twenty years, both of which did not allow bringing subsidy cases involving nonmarket economies, principally China.

China has consistently argued that the cases filed by the U.S. on these issues were unjustified. “U.S. filing complaints in the WTO over alleged commercial piracy in China will badly damage cooperation.”¹⁸ In the U.S. Court of International Trade case, China has taken an even stronger position. “The Chinese government expresses strong dissatisfaction about the U.S. decision to impose penalty tariffs against the imports of Chinese coated free sheet paper.”¹⁹

Ambassador Susan C. Schwab, the U.S. trade representative, says bringing trade actions should not be viewed as a failure in trade relations. “We have brought four formal WTO cases in the past fourteen months and we are determined to press our cases vigorously in the months ahead. This should not be regarded as a failure in our trade relationship with China. Quite the contrary. Resorting to dispute settlement is itself a form of engagement. It is evidence of two countries working to resolve disputes about obligations through neutral, legal mechanisms. WTO dispute settlement is designed to prevent trade wars rather than fuel them.”²⁰

International Negotiations

The reliance of the U.S. on WTO litigation points to faulty international negotiations.²¹ In May 2007, the Second China Strategic Dialogue in Washington, D.C., the more recent negotiations in Beijing and the Group of Seven (G-7) meeting (even though it stepped up pressure on China in currency valuation) failed to produce any significant results.²² Neither has the older U.S.-China Joint Commission on

China Litigation in the WTO (2003–07)

Complainant	Party	Status	Number	Agreement
U.S. Steel Safeguards	T.P. Complainant	AB Report 2003	DS 252	Safeguards
U.S. A/D & CVD	Complainant	Request Consultation 2007	DS 368	Dumping & Subsidies
Respondent				
China’s VAT on Integrated Circuits	Respondent	Mutually Agreed Solution 2005	DS 309	GATT 1994
China Auto Parts	Respondent	Request Consultation 2006	DS 340	GATT 1994, Subsidies
China’s Subsidies & Refunds	Respondent	Request Consultation 2007	DS 358	Subsidies
China’s Intellectual Property Rights	Respondent	Request Consultation 2007	DS 362	Intellectual Property
China’s Distribution System	Respondent	Request Consultation 2007	DS 363	Services

Commerce and Trade produced any important outcomes.²³ This failure of negotiations is occurring while China remains the target of the largest number of antidumping actions brought by countries worldwide (thirty-six during July to December 2006).²⁴ The EU is considering filing newer cases and adopting a more aggressive approach.²⁵ European steel makers recently asked the European Commission to impose antidumping duties on steel, and this appears to be an opening shot in a looming trade war with China.

Congressional Legislation

While the Bush administration is moving forward with its trade litigation, there are various bills in Congress proposing a host of stronger actions against China. Each could have potentially serious consequences for trade with China. Describing them is like photographing the sand on a beach during a windstorm.²⁶ However, what is particularly unique is that congressional legislation for the first time would include WTO litigation as a sanction.

The Senate Finance Committee bill (sponsored by Max S. Baucus, Charles E. “Chuck” Grassley, Charles E. Schumer and Lindsey O. Graham) defines dumping by considering undervaluation of foreign currency.²⁷ This approach is tamer than earlier bills. However, this bill would require the United States Trade Representative (USTR) to file a WTO action within a year of the Department of the Treasury determining that a nation’s currency is “misaligned.” Leading Democratic presidential contenders (Hillary Clinton and Barack Obama) have signed on to this approach.²⁸ The Bush administration opposes this strategy.²⁹ “Public opinion polls show rising discontent with globalization among Republicans and Democrats alike.”³⁰

Given the time it will take for enactment of the legislation, required Treasury Department action, the USTR request to the WTO, and the WTO’s process of panels and appeals, late 2010 is the earliest any WTO action could occur. This lengthy timeline for possible action

under this bill indicates that passing legislation is not necessarily the most efficient or effective way to address these trade issues. Reinvigorated negotiations become more attractive, with a promise of a quicker resolution.

The earlier Senate bill (sponsored by Schumer and Graham) would authorize 27.5 percent duties on all imports to counter the undervaluation of the yuan. This bill also presents a novel possibility—action in the WTO. The bill declares that as a general principle the undervaluation of currencies amount to an export subsidy.

The Senate Banking Committee bill (sponsored by Christopher J. Dodd and Richard C. Shelby) requests the Treasury Department to take actions over global currency imbalances and currency manipulation. This measure is clearly aimed at China.

A bill in the House of Representatives (sponsored by Arthur G. Davis and Philip English) would allow subsidy actions as to nonmarket economies. It would codify both the Bush administration’s policy and the decision of the U.S. Court of International Trade in the *High-Gloss Paper* authorizing subsidy actions against imports coming from nonmarket economies.

The Bush administration has warned against all of the above legislation.³¹ It emphasizes China as a source of affordable consumer products and a marketplace for American exports. In particular, the administration has supported negotiations with litigation as a central component of its trade policy. Recently, the Bush administration denied a Section 301 petition seeking to launch a WTO case against China concerning the valuation of the yuan.³²

Assessment

In summary, the U.S. filed two cases against China in the WTO soon after China’s accession in 2001. Since the midterm elections in 2006, the Bush administration has launched a more aggressive trade policy against China in

the WTO, filing an additional three cases. Panels have been established and decisions are expected by late 2008.

The Bush administration’s newer trade policy is in response to the swing in power in the Congress.³³ The Democrat-controlled Congress has become more resistant to President Bush’s trade policies, which have involved opposition to fast-track extension and the approval of various bilateral trade agreements (with South Korea, Panama, Peru, and Colombia). The Bush administration’s approach is an obvious response to the Democratic Party’s focus on a “new populism,” emphasizing “trade and jobs.”³⁴ This shift joins a growing popular resistance to globalization and trade, growing concern over product and food safety, and increasing Republican Party resistance, as well. Congressional backlash is in large part based on continuous failure by the Treasury Department to determine that China has manipulated the yuan and declare such manipulation to be a prohibited trade restriction.

The Treasury Department failed to take this action again in its semi-annual report to Congress on foreign exchange, issued in June 2007. However, the Treasury Department’s cautionary position is understandable. The provisions of the WTO agreements do not consider currency valuation in the context of a trade restriction, let alone declare them as inconsistent with the WTO.³⁵

The Bush administration’s policy also is a reaction to international diplomacy failures. Bilateral negotiations with China and the Doha trade negotiations have been disappointments. Successful bilateral trade talks hold the promise of resolving difficult disputes. Success in multilateral negotiations offers the possibility of adoption of newer rules for the general trading system. Developing and clarifying rules through multilateral negotiation is the optimal solution. U.S. trade efforts should be focused on this approach.

Of course, this newer U.S. trade policy is in the context of myriad international economic and political factors. China’s eco-

China Investment Data

Foreign Direct Investment

Outflow — 2006	\$11.3 billion
Outflow — 1996	\$2.1 billion

Direct Investment Positions

Inward — 2005	\$610.2 billion
Outward — 2005	\$64.5 billion

International Direct Investment Database,
Organisation for Economic Co-operation and
Development, Paris, 2006

conomic development and growth is huge. China's gross domestic product in the first quarter was a twelve-year high at 11.9 percent. China could well grow this year at the fastest rate since 1993 and bring it closer to overtaking Germany as the world's third-largest economy.³⁶ China has an overvalued currency, and global economic balances persist. The U.S. economy is slowing. China's demand for imports is fueling a global economic expansion. China is on course to lead the world in initial public offerings.³⁷ The initial public offering of the Industrial and Commercial Bank of China in July 2007 made ICBC the world's largest bank by capitalization. Two months later, this IPO was surpassed by that of China Construction Bank Corp. China's stock market has reached an all-time high (six thousand in October 2007). In November, after its public offering, PetroChina became the world's first \$1,000bn company. A day later, the public offering of Alibaba.com made it the world's second largest Internet company. China now leads the world in publicly traded companies with more than \$200 billion in market capitalization.³⁸ China's sovereign wealth fund, the China Investment Corporation, is preparing to invest globally.³⁹

Within a geopolitical context, China is becoming of great importance and concern to the United States. For example, there has been increased cooperation between Russia and China in Central Asia within the new Shanghai Cooperation Organization. China has been a key participant in the nuclear negotiations with North Korea. "[C]hinese nationalism backed by economic

strength—poses obvious foreign policy dilemmas for the west."⁴⁰ The ideological battles over which model is best for economic development will continue. "Authoritarian nationalism" is challenging the Western political model that embraces liberal democracy.⁴¹ "State capitalism" seems more appropriate for defining the market in China.⁴²

The new U.S. trade actions against China in the WTO could easily spill into a larger trade war.⁴³ Initially, it could lead to new Chinese restrictions on U.S. multinationals investing in China and China's investment in the U.S.⁴⁴ The U.S. multinationals doing business in China and U.S. exporters to China would pay the price for U.S. import restrictions.⁴⁵ This possibility is particularly worrisome since China is generating significant earnings in a generally slowing U.S. economy. The U.S. economy is "decoupling" from the global economy as the economic locomotive of global growth. "[T]he global economy is moving into a newer era in which growth in developing parts of the world becomes the key component of economic expansion."⁴⁶

Ultimately, the trade conflict could affect the U.S. political and national security relations with China. Changing some specific practices of China or tweaking U.S. trade law are not going to change the fact that China is a rapidly developing, emerging-market powerhouse. China is poised to become the largest trading nation in the world. There is a need to develop other remedies for the U.S.-China trade conflict. Developing less unilateral and confrontational actions on both sides is preferable.

The bigger issue still warrants discussion. Has WTO litigation become the weapon of choice for the United States because there has been a failure of diplomacy

within the WTO system?⁴⁷ The answer is yes. The possible implications of this reality are huge. Litigated decisions are applicable only to the individual parties to a case. While litigation does hold the promise of coaxing states back to the negotiating table litigation simply does not hold the answer for developing general rules addressing ever more complex issues of trade relations—rules that are applicable to all WTO members. Is it better for global trade relations to be centered on the WTO Dispute Settlement Understanding system than on the seemingly never-ending Doha negotiations or bilateral negotiations over trade disputes? Here, the answer is no. Trade disputes are better settled within the dispute resolution system. While individual or a range of trade disputes may be settled by bilateral negotiations, it is crucial for trade relations to be grounded in multilateral negotiations through which policy choices are made by the parties for the benefit of themselves and the global trading system. Professor Robert Z. Lawrence of Harvard University states, "The shift from bilateral to multilateral enforcement helps secure the legitimacy of the trading system and reduces the political costs associated with bilateral dispute settlement."⁴⁸ He concludes, "There are other reasons to be wary of an aggressive move toward tougher enforcement . . . [The] dispute settlement system reflects a subtle amalgam of the legal and diplomatic approaches . . ."⁴⁹

This grounding means reinvigorating the current round of WTO negotiations to develop newer rules for both broader and more technical trade issues. As trade relations continue to evolve, these issues will undoubtedly encompass a greater range of economic relations than does the

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Official China Web Sites For Foreign Affairs & Foreign Commerce

Chinese Mission to the World Trade Organization
China Ministry of Foreign Commerce (MOFCOM)
China's Foreign Market Access Report (MOFCOM)
China Ministry of Foreign Affairs
China Embassy to the U.S. (Economic & Commercial)

<http://wto2.mofcom.gov.cn/aboutus/aboutus.html>
<http://english.mofcom.gov.cn/>
<http://gpj.mofcom.gov.cn/table/2005en.pdf>
<http://www.fmprc.gov.cn/eng/>
<http://us2.mofcom.gov.cn/index.shtml>

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existing rules-based system. It also means taking greater advantage of the consultation stage in the dispute resolution system, where it can be more effectively utilized to settle contentious cases involving specific and divisive trade issues. This stage requires traditional diplomatic negotiations to occur in a confidential context. This reliance on more vigorous negotiations would be better for U.S.-China bilateral relations and enhance global governance of trade. Furthermore, it would strengthen the rules-based multilateral system.⁵⁰ The WTO Director-General Pascal Lamy recently concluded, “[T]he WTO is an engine, a motor energizing the international legal order . . . a catalyst for international mutual respect towards international coherence and even for more global governance, which I believe is needed if we want the world we live in to become less violent . . .”⁵¹ ☞

Endnotes

- 1 “The biggest challenge in international economic policymaking is the incorporation of China (into the trading system).” Martin Wolf, “The Right Way to Respond to China’s Exploding Surpluses,” *Financial Times* (May 30, 2007).
- 2 For a general review of WTO litigation and the role of the United States in it, see Malawer, “Litigation and Consultation in the WTO: 10th Anniversary Review,” *Virginia Lawyer* (June/July 2005). See also, Lawrence, “The U.S. and the WTO Dispute Settlement System.” (Council on Foreign Relations 2007).
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- 4 DS 358.
- 5 DS 359.
- 6 Official USTR Releases: “U.S. Files WTO Cases Against China.” (*USTR* April 9, 2007); “IPR Legal Regime.” (*USTR* April 9, 2007); “Market Access Restrictions.” (*USTR* April 9, 2007).
- 7 DS 362.
- 8 DS 363.
- 9 DS 309.
- 10 “U.S. and China Resolve WTO Dispute Regarding China’s Tax on Semiconductors.” (*USTR News* 9.15.06).
- 11 “U.S. Requests WTO Panel in China’s Treatment of Auto Parts.” (*USTR News* July 8, 2004).
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- (*EU Press Release* September 5, 2006); “U.S. Auto Action Against China.” (*USTR Press Release* September 25, 2006); “China’s Reaction.” China Ministry of Commerce (MOFCOM) *News Release* (September 20, 2006).
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- 17 The U.S. Court of International Trade refused to stop the action on subsidies against China that is pursuant to the U.S. government’s new policy that imports from nonmarket economies (NME) may be considered a subsidy and subject to countervailing duties. *People’s Republic of China v. U.S.* (Court No. 07-00010) (March 29, 2007). “China Dissatisfied with Trade Action.” (China Ministry of Commerce, *Press Release* April 3, 2007).
- 18 “China Trade Mission to the WTO News Release.” (April 25, 2007).
- 19 “China’s Ministry of Commerce News Release.” (April 3, 2007).
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- 21 “China-U.S. Talks Continue, Amid Legal Volleys,” *New York Times* (July 30, 2007).
- 22 “G-7 Steps Up Pressure on China on Currency,” *Washington Post* (Oct. 22, 2007).
- 23 “The U.S.-China Joint Commission on Commerce and Trade (JCCT)—Outcomes on U.S. Request.” (*USTR* April 11, 2006). The annual report concerning China’s WTO compliance released by the USTR contends compliance has been a mixed picture. “2006 Annual Report on China’s WTO Compliance.” (*USTR* 2007). The USTR released the 2007 special intellectual property report, which singled out China and Russia as the main offenders. 2007 Special 301 Report (*USTR* 2007). See also, “U.S. China Trade Relations: Entering a New Phase of Greater Accountability and Enforcement—Top-to-Bottom Review.” (*USTR* 2006).
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- 29 “Paulson Warns Against Legislation on China,” *New York Times* (September 11, 2007).
- 30 “A Shift in Bush’s Trade Politics,” *Washington Post* (October 10, 2007).
- 31 “Showdown Looms on China Trade,” *Wall Street Journal* (June 5, 2007).
- 32 “Administration Declines Section 301 Petition on China’s Currency Policies.” *USTR Press Release* (6.13.07).
- 33 “Free-Trade Fight Reflects Broader Battle,” *Washington Post* (October 12, 2007); “How a Breakthrough in Trade Broke Down in Congress,” *Washington Post* (November 22, 2007).
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 - WTO/GATT—Article XV [“Exchange Arrangements”] (4): “Contracting parties shall not, by exchange action, frustrate the intent of the provisions of this Agreement . . .”
 - International Monetary Fund Agreement—Article IV [“Obligations Regarding Exchange Agreements”] (1)(iii): “. . . avoid manipulating exchange rates or the international monetary system in order . . . to gain an unfair competitive advantage over other members . . .”
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- 37 “China on Course to Lead World IPO League,” *Financial Times* (July 5, 2007).
- 38 “There’s Peril in the Parallels as China Takes a Top Spot,” *New York Times* (October 20, 2007).
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- 40 Gideon Rachman, “Russia and China Challenge the West,” *Financial Times* (October 23, 2007).
- 41 Gideon Rachman contends that both Russia and China present an ideological challenge to the West by relying on “authoritarian nationalism,” rather than embracing liberal democracy for their economic prosperity. He poses the intriguing question, “Was it wrong to suppose globalisation and economic growth would eventually mean that Russia and China would become liberal democracies?” It seems wrong to conclude that the end of the Cold War meant that ideological arguments concerning economic prosperity were over.
- 42 Martin Wolf, “We Are Living in a Brave New World of State Capitalism,” *Financial Times* (10.17.07). He states, “The big truth is that contemporary

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globalization has brought players into the game that operate by different rules from those espoused by today's high-income countries; vast state-owned companies . . . countries that accept a bigger role of the state in markets than western countries do today."

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- 45 "U.S. industry is divided over a decision by the Bush administration to file two cases today against China at the World Trade Organization over restrictions on foreign media and piracy." "US Pressure on China Divides Industry," *Financial Times* (April 9, 2007).
- 46 "China and India Will Shield GE from U.S. Downturn, says Immelt," *Financial Times* (October 29, 2007).
- 47 For an earlier discussion of litigation versus negotiation within the WTO system *see*, Esserman and Howse, "The WTO on Trial," 82 *Foreign Affairs* 130 (January/February 2003). The authors state, "Less often considered is whether this ascendant legalism is good or bad for global prosperity and stability. In most cases, it turns out, it is still too early to say. There is one exception, however: the WTO. Nowhere else has international conflict resolution by judges emerged more forcefully or developed more rapidly . . . An accurate assessment of the WTO's judicial record finds that the system has indeed reduced the role of international diplomacy, while strengthening the rule of law." *See also*, "And if negotiations are fruitless, litigation takes over" in "How Lawsuits are Coming to Dictate the Terms of Trade," *Financial Times* (March 20, 2007). "[T]he World Trade Organization system has so far done a good job of holding protectionist sentiment in check." "Tight Rules are Keeping a Lid on Trade Wars." *Financial Times* (June 5, 2005).
- 48 Lawrence, "The U.S. & the WTO Dispute Settlement System." 6 (Council on Foreign Relations 2007).
- 49 *Id.* at 18 and 20.
- 50 Director-General of the WTO Pascal Lamy declares in "WTO & Global Governance" (November 1, 2006) that "The WTO is nevertheless a laboratory for harnessing globalization and contributing to the construction of a system of global governance. A place where evolving global governance can find some roots in ensuring legitimate decision-making."
- 51 Pascal Lamy, "The Place and Role of the WTO (WTO Law) in the International Legal Order." *WTO News Release* (May 19, 2006) (address before the European Society of International Law).