

# WTO Panel issues ruling on U.S. tariffs against China

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On 15 September 2020, a World Trade Organization (**WTO**) Panel report in “**United States – Tariff Measures on Certain Goods from China**” (WT/DS543/R) (the **Report**) was published. The Report ruled that tariffs imposed by the United States against China in 2018 – as part of the so-called “trade war” between the two nations – violated the General Agreement on Tariffs and Trade (the **GATT**). In its decision, the Panel concluded that the tariffs were discriminatory and excessive, and not justified on public moral grounds under Article XX of the GATT.

In this note, we set out the background to the Report, examine the Panel’s key findings and consider the implications of this important decision.

## Background to the Report

In April 2018, the United States Trade Representative (**USTR**) released the outcome of its investigation into China’s acts, policies and practices related to technology transfer, intellectual property and innovation under section 301 of the Trade Act of 1974 (the **USTR Report**). Following the USTR Report’s finding that China’s technology transfer and intellectual property policies, as set forth in its industrial plans such as “Made in China 2025”, were harming U.S. companies, the U.S. started implementing several rounds of escalating tariffs on certain Chinese imports.

In response, China challenged the following measures adopted by the U.S. before the WTO:

- additional *ad valorem* duties, imposed on 20 June 2018, on a list of 818 tariff subheadings with an approximate annual trade value of USD34 billion of products imported from China, as of 6 July 2018 (**List 1**); and

- additional *ad valorem* duties, imposed on 21 September 2018 on a list of 5,745 tariff subheadings with an approximate annual trade value of USD200bn of products imported from China, as of 24 September 2018 (**List 2**). The additional duties were set at 10% until the end of 2018 and were set to increase to 25% on 1 January 2019. The increase in the rate of additional duties was postponed twice and was ultimately increased from 10% to 25%, as of 10 May 2019.

## China's WTO challenge

Before the WTO Panel, China claimed that the U.S. had violated Article I:1 of the GATT through its application of additional tariffs that apply only to products originating from China. Article I:1 of the GATT contains the “most favoured nation” principle which provides that WTO Members must not discriminate between “like” products originating from or destined for any other WTO Member.

China also claimed that the U.S. had violated Article II:1(a) and (b) of the GATT through its application of additional tariffs in excess of those contained in its WTO Schedule of Concessions and Commitments (the “agreed bound tariff rate”) and accorded imports from China “less favourable treatment” than that provided in the U.S.’ Schedule.

## U.S. public morals defence

The U.S. did not seek to refute China’s assertion that the measures are inconsistent with Articles I:1 and II:1 (a) and (b) of the GATT. Rather, in its substantive response, the U.S. argued that any inconsistency of the tariff measures with the GATT are justified under Article XX(a) as they were measures “necessary to protect public morals”. This is because, according to the United States, China’s acts, policies and practices, as addressed in the USTR Report, amount to “state-sanctioned theft and misappropriation of U.S. technology, intellectual property and commercial secrets” which violates the public morals prevailing in the U.S.

To provisionally justify its defence, the Panel held that the U.S. needed to establish that there is a “sufficient nexus between the measure and the interest protected”. The U.S. argued that the measures at issue protect public morals, within the meaning of Annex XX(a), because they have been adopted to “‘obtain the elimination’ of conduct that violates U.S. standards of right and wrong, namely China’s unfair trade acts, policies, and practices”.

In support of its argument, the U.S. submitted as evidence various U.S. domestic law instruments that outlaw some, although not all, of the Chinese practices documented in the USTR Report. In particular, the U.S. argued that the Chinese practices violated U.S. “standards of right and wrong” such as the prohibition of theft, extortion,

cyber-enabled theft and cyber-hacking, economic espionage and the misappropriation of trade secrets, anti-competitive behaviour, as well as the regulation of government takings of property.

In response, China argued that the tariffs at issue are underpinned by economic concerns and are not designed to shield U.S. public morals from imported goods that contain offensive content or embody offensive content.

## WTO Panel conclusions

The Panel observed that, in its view, a measure may be found to pursue a public morals objective even if it has economic aspects. Further, the “standards of right and wrong” invoked by the U.S. (including norms against theft, misappropriation and unfair competition) could, at least at a conceptual level, be covered by the term “public morals” within the meaning of Article XX(a) of the GATT.

In this respect, the Panel concluded that the public morals objective as invoked by the United States reflect societal interests and values that appear to be highly important to the United States.

The Panel found, however, that the U.S. had not demonstrated that there is a genuine relationship between the measures at issue and the public morals objective being pursued. The U.S. had argued that the additional duties at issue were necessary to protect public morals because they play a necessary role toward the goal of eliminating China’s unfair trade acts, policies and practices by raising the cost of such practice and reducing China’s incentive to continue engaging in such conduct going forward. The U.S. further argued that there was a clear and direct relationship between the List 1 products and the unfair practices described in the USTR Report.

The Panel held, however, that the U.S. had not provided sufficient evidence to substantiate that the List 1 products benefited from Chinese industrial policies. Rather, the range of products on List 1 appeared to be related to the risk of disruption to the U.S. economy and the value of the products imported.

Furthermore, the Panel found that it was unclear how the U.S. had associated China’s industrial policies with specific products within certain economic sectors that benefit from China’s policies and practices considered to violate the public morals invoked by the U.S.

In addition, the Panel held that the U.S. did not provide an explanation that would allow the Panel to understand the relationship between the additional duties on the List 2 products – which applied to a broader class of products and were said by the U.S. to reinforce the imposition of Line 1 duties in order to apply stronger economic pressure on China – and the public moral objectives invoked by the U.S. As such, in respect of both List 1 and List 2 the U.S. had not demonstrated that there is a “genuine relationship of ends and means between the measures at issue and the public morals pursued by the United States”.

In light of the above, the Panel found that the U.S. had not met its burden of demonstrating that the measures are provisionally justified under Article XX(a) of the GATT. As a consequence, the Panel concluded that the U.S. measures at issue are inconsistent with the specified articles under the GATT and recommended that United States bring its measures into conformity with its obligations.

## Implications of the ruling

In a statement released following the decision, the USTR criticised the Report, saying that it confirms that the WTO is “completely inadequate to stop China’s harmful technology practices”. The USTR also stated that the actions USTR took in response to China’s practices led to the Economic and Trade Agreement between the United States and China (the so-called “Phase One” Agreement) which is unaffected by the Report.

In practical terms, the decision is unlikely to have much impact.

Whilst the United States has 60 days from the date of the Report to appeal against its findings, the U.S. has blocked the appointment of new judges to the WTO’s Appellate Body. As such, if the United States decided to appeal the decision, the case could enter a form of paralysis as there is no functioning Appellate Body to consider the appeal. Equally, it seems unlikely that any further retaliatory action will follow from China if the U.S. does not comply with the Panel’s findings, since it has already imposed tariffs in response to the U.S. measures under challenge. Therefore, with the U.S. Presidential election being less than 50 days away, all eyes are now firmly turned to whether the outcome of that democratic process will result in any change of U.S. trade policy towards China.

Should you have any questions on any matters discussed in this bulletin, please contact the authors or any member of our International Trade and Regulatory Law Group.