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May 10, 2017

The Honorable Wilbur L. Ross, Jr.
Secretary of Commerce
U.S. Department of Commerce
14th St. & Constitution Ave., N.W.
Washington, D.C. 20230

The Honorable Stephen Vaughn
Acting U.S. Trade Representative
Office of the U.S. Trade Representative
600 17th Street, NW, Room F516
Washington, D.C. 20508

Re: Comments Regarding Causes of Significant Trade Deficits for 2016, Docket Number DOC 2017-0003

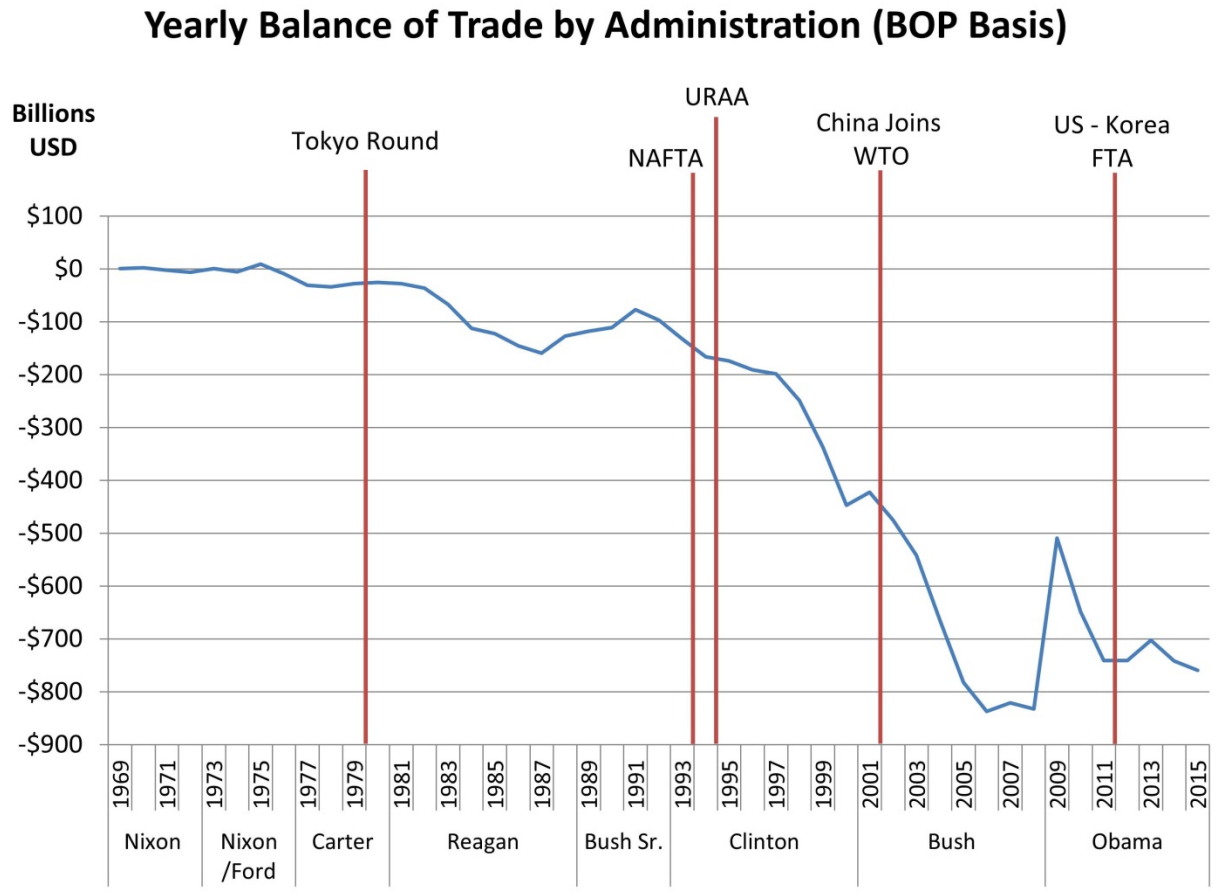
These comments are submitted on behalf of the author and are the author's own views, not necessarily reflecting views of any firm clients or other members of the firm.

First, the Administration is to be congratulated on conducting a review of our trade deficit in goods trade. There has not been a serious examination of the issue and whether the sizeable deficit is problematic to our manufacturing and agricultural producers in a number of decades. While countries may run a trade surplus or trade deficit with particular trading partners for a variety of reasons including currency swings and short-term deficits in total are not a concern in themselves, the United States has seen a dramatic worsening of its trade deficit over the last forty-five years. While running a trade deficit was viewed as problematic when it first arose in 1971, leading then President Nixon to impose a temporary import surcharge of 10%, many economists and seemingly many of our Congressional, Administration and business leaders have viewed the mounting deficit as a matter of little or no concern, despite the fact that no other nation on earth has amassed the size of trade deficit in goods the U.S. has done in the last forty-five years.

The long-term decline of our trade balance is not a question of being a developed or advanced country, as neither Japan nor Germany face merchandise deficits of any size (and Germany runs a large trade surplus) despite having heavy oil and gas import dependency. The chart on the following page maps the U.S. yearly balance of trade from 1969 to the present and identifies when various trade negotiations concluded and/or China entered the WTO. Concerns that some regional or bilateral agreements and our multilateral agreements have not achieved all that was

hoped for is consistent with the worsening trade deficits following the conclusion of the Tokyo Round and the Uruguay Round of trade negotiations as well as the entry into force of NAFTA and the U.S.-Korea agreement. Finally, China's entry into the WTO has witnessed a sharp worsening of our trade deficit. *See* http://www.stewartlaw.com/Article/ViewArticle/1064.

There are, of course, many issues that the Administration and Congress should be reviewing in addressing the core challenges to our competitiveness. The tax structure, regulatory environment, infrastructure, innovation ecosystem (including scientific research, IP enforcement), and lifetime education are a few of the issues typically identified as critical to improving competitiveness. But the distortions from the trading system – whether existing WTO rules that discriminate against countries like the U.S. without a heavy reliance on indirect taxes, nontariff barriers, economic systems that don't operate consistent with market economy norms, and others – obviously play an important role as well in driving the deficits year after year.



The April 17, 2017 Federal Register identifies countries with which the U.S. ran a large trade deficit in 2016 (apparently defined as $10 billion dollars). The countries of concern (or the customs union) and the U.S. 2016 balance of trade and 1989-2016 balance of trade are shown below as well as the percent change from 1989-2016 and the 1989 trade balance:

Country	U.S. Trade Balance			
	2016	1989-2016	% change 1989-2016	1989
Canada	-$12.1 billion	-$951.9 billion	+21.8%	-$9.9 billion
China	-$347.0 billion	-$4,349.1 billion	+5,514.4%	-$6.1 billion
European Union	-$146.3 billion	-$1,896.3 billion	+11,253.8%	-$1.3 billion
India	-$24.3 billion	-$242.3 billion	+2,756.1%	-$0.9 billion
Indonesia	-$13.2 billion	-$203.1 billion	+475.9%	-$2.3 billion
Japan	-$68.9 billion	-$1,821.5 billion	+40.7%	-$49.0 billion
Korea	-$27.7 billion	-$303.5 billion	+341.7%	-$6.3 billion
Malaysia	-$24.8 billion	-$355.6 billion	+1,227.3%	-$1.9 billion
Mexico	-$63.2 billion	-$901.8 billion	+2,749.8%	-$2.2 billion
Switzerland	-$13.7 billion	-$36.3 billion	+6,439.3%	-$0.2 billion
Taiwan	-$13.3 billion	-$354.2 billion	+2.0%	-$13.0 billion
Thailand	-$18.9 billion	-$278.2 billion	+807.8%	-$2.1 billion
Vietnam	-$32.0 billion	-$198.7 billion	-303,933.7%	+$0.01 billion
Subtotal	-$805.4 billion	-11,892.5 billion	+746.0%	-$95.2 billion

These countries accounted for more than 100% of the trade deficit in 2016 (109.5% of the total deficit in goods of $735.5 billion) and close to 100% for the entire period 1989-2016 (92.3% of the trade deficit of $12,888.2 billion).

Attached as Exhibits 1-28 are tables looking at the U.S. trade balance with all countries for the period 2012-2016 by 2-digit HS level of detail and 4-digit HS level of detail as well as similar charts for each of the countries (including for the EU with 28 members). Also attached as Exhibits 29 – 32 are tables that look at the U.S. trade balance for all countries combined by 2-digit HS level of detail for two periods (based on organization of USITC webpage data) 1996-2016 and 1989-1995, as well as the U.S. trade balance by country for 1996-2016 and 1989-1995.

Overarching issues

1. Discrimination based on difference between direct and indirect taxes

The United States and Saudi Arabia are two of the only countries who have not adopted significant indirect taxes at the federal level (in the U.S., state sales taxes exist at the individual state level). Because of an agreement more than sixty years ago as part of the General Agreement on Tariffs and Trade, which has continued under the World Trade Organization, countries can treat direct taxes (*e.g.*, income taxes) and indirect taxes (*e.g.*, sales taxes or value-added taxes) differently both upon importation and upon exportation. As the U.S. has not moved to the use of indirect taxes, U.S. companies and their workers face discrimination both in the U.S. market as imports from countries with indirect taxes can rebate those taxes on export and in foreign markets as other countries can impose the indirect taxes on U.S. goods when imported into their market. Since the early 1960s, this has been an issue of concern to Administrations

and to Congresses alike, but no solution has been found that has been acceptable to Congress. *See*, *e.g.*, Issues for Businesses to Consider Should the Incoming Administration Choose to Address the Trade Deficit in Part Through Trade or Tax Actions, December 29, 2016, http://www.stewartlaw.com/Article/ViewArticle/1086; Trade Lawyers Advisory Group, More than 50 Years of Trade Rule Discrimination on Taxation: How Trade with China is Affected, August 2007, http://www.uscc.gov/Research/more-than-50-years-trade-rule-discrimination-taxation-how-trade-china-affected.

All of the countries listed in the Federal Register have value-added taxes that apply to most goods and hence contribute to the trade deficits the U.S. runs with the identified countries (it also reduces the surpluses or adds to the deficits of any other country with a VAT or similar indirect tax system). The 2017 standard VAT rate for each of the countries is shown below:

Nation	VAT Standard Rate	Nation	VAT Standard Rate
Austria	20%	Lithuania	21%
Belgium	21%	Luxembourg	17%
Bulgaria	20%	Malaysia	6%
Canada	5%	Malta	18%
China	17%	Mexico	16%
Croatia	25%	Netherlands	21%
Cyprus	19%	Poland	23%
Finland	24%	Portugal	23%
France	20%	Romania	19%
Germany	19%	Slovakia	20%
Greece	24%	Slovenia	22%
Hungary	27%	Spain	21%
India	15%	Sweden	25%
Indonesia	10%	Switzerland	8%
Ireland	23%	Taiwan	5%
Italy	22%	Thailand	7%
Japan	8%	United Kingdom	20%
Korea	10%	Vietnam	10%
Latvia	21%		

The House Republican leadership had identified a border adjustability provision as an important part of a possible tax package in *A Better Way: Our Vision for a Confident America – Tax*, June 24, 2016. http://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf. Border adjustability has been opposed by retailers and other significant importers and was not part of the President's proposed tax reform.

Addressing the current system of international rules to eliminate the discrimination against U.S. goods or adopting some form of indirect tax system should be an important part of the

Administration's efforts to address the systemic causes of our trade deficit. For example, in negotiating new FTAs or renegotiating existing FTAs, the U.S. could pursue elimination of the rebate on indirect taxes with FTA partners and eliminate assessment of such taxes on imports. A permutation would be to limit the rebate to the level of indirect taxes assessed upon importation and limit the assessment to the level of indirect taxes rebated. A multilateral approach seems less achievable in light of the more than half century of efforts by the U.S. at the GATT and now the WTO to have the issue considered.

The New York Times had an article by Keith Bradsher and Karl Russell that ran on March 7, 2017, entitled "Building Trade Walls," which shows two maps of the world, one that reflects bound tariff rates and one that shows a combination of bound tariff rates and indirect taxes like VAT or sales taxes. The maps visually demonstrate the artificial disadvantage U.S. companies face because of the distinction between direct and indirect taxes. *See* https://www.nytimes.com/interactive/2017/business/tradechinaprotectionism.html?_r=0. "Once value-added taxes and sales taxes are included in an international comparison, America's trade barriers are much lower than those of almost every other country."

2. Motor vehicles and parts

One of the major sources of our trade deficit with the world and with most of the countries identified in the Federal Register is the U.S.' very lopsided trade relationship on motor vehicles and parts thereof. Between 1989 and 2016, the U.S. amassed a trade deficit in Chapter 87 of the Harmonized Schedules (vehicles, other than railway or tramway rolling stock, and parts and accessories thereof) of $2,408.6 billion, or 18.7% of the total deficit with all countries over that time frame.

For a number of the countries listed, the U.S. trade balance in Chapter 87 constitutes a large part of the trade deficit with the country in 2016:

European Union,	26.14% of total trade deficit
Canada,	80.94%
Mexico	84.55%
Japan	70.02%
Korea	68.12%
Taiwan,	16.52%

The 2017 National Trade Estimate reviews a wide variety of challenges U.S. motor vehicle and parts producers face in each of the countries/customs union shown in the Federal Register, other than for Canada and Mexico. Exhibits 33-43 are excerpts from the 2017 NTE for each relevant country. In addition to non-tariff barriers, U.S. exporters face much higher tariffs imposed by many countries shown – China, Malaysia, Vietnam, India, Indonesia, Taiwan and Thailand. The U.S. has, of course, FTAs with Canada, Mexico, and Korea. Tariffs in Switzerland for imports under Chapter 87 are 0% and those in the EU and Japan are generally similar to the U.S. (higher on some; lower on others). Exhibits 44-53 are the applied tariffs for our non-FTA partners as

downloaded from the WTO's Integrated Database (IDB), http://tariffdata.wto.org/Default.aspx?culture=en-US0.

3. Agricultural products

Generally the U.S. faces a wide variety of nontariff and tariff barriers abroad which greatly restrict U.S. exports of agricultural products. Sanitary and phytosanitary requirements are often used as barriers to trade and/or are often not science-based despite WTO and FTA obligations to the contrary. For example, U.S. exporters of many agricultural commodities have been denied access to the European market because of the delays or failure to approve genetically modified products for sale in the European market. USTR issued a 2014 Report on Sanitary and Phytosanitary Measures around the world including measures in most of the countries that are the subject of the trade deficit report (all but Canada). *See* https://ustr.gov/sites/default/files/FINAL-2014-SPS-Report-Compiled.pdf. However, Canada is listed in the 2017 National Trade Estimate for a variety of practices (whether SPS, TBT, supply management or other) that adversely affect U.S. exports of agricultural products to Canada. *See* 2017 National Trade Estimate on Foreign Trade Barriers at 65-68 (restrictions on U.S. seed exports, cheese composition standards, agricultural supply management (dairy, chicken, turkey and egg), milk classes, restrictions on U.S. grain exports), https://ustr.gov/sites/default/files/files/reports/2017/NTE/2017%20NTE.pdf.

Some countries are believed to be violating their WTO obligations on domestic support levels for agricultural products or market access obligations. For example, the U.S. has three cases currently pending at the WTO, two against China and one against Canada – (1) DS520 Canada – Measures Governing the Sale of Wine in Grocery Stores; (2) DS517 China – Tariff Rate Quotas for Certain Agricultural Products; (3) DS511 China – Domestic Support for Agricultural Producers.

For tariff rates on agricultural products, *see* the WTO's Integrated Database (IDB); *see also* World Tariff Profiles 2016, pages 16-21 (agriculture tariffs by country), 61 (Canada), 65 (China), 81 (EU), 96 (India), 97 (Indonesia), 100 (Japan), 106 (Korea), 114 (Malaysia), 119 (Mexico), 160 (Switzerland), 161 (Taiwan), 164 (Thailand), 175 (United States of America), 180 (Vietnam), https://www.wto.org/english/res_e/booksp_e/tariff_profiles16_e.pdf. For countries with which the U.S. does not have an FTA, U.S. agricultural tariffs are generally significantly lower. For example, Japan has tariffs as high as 595 percent and average tariffs on dairy products of 92.1%, and on cereals and preparations of 54.1%. These compare to U.S. averages of 16.8% and 3.5%, respectively. Similarly, Switzerland had tariffs that go above 1,000% in both categories relating to animal products and categories relating to fruits, vegetables, and plants, with average tariffs of 135.5% on animal products, 155.7% on dairy products, 58.0% on oilseeds, fats and oils, 44.0% on cereals and preparations, and 32.0% on beverages and tobacco. U.S. tariffs by comparison are 2.3%, 16.8%, 4.4%, 3.5% 14.8%. India's average tariff on all agricultural products is above 100% except dairy (65.0%). European Union average tariffs on all categories of agricultural products are higher than their U.S. counterpart except for cotton (EU average of 0% vs. U.S. average of 4.8%).

4. Other non-tariff barriers

A wide range of trade barriers are listed for each country/customs union subject to the trade deficit study in the 2017 National Trade Estimate on Foreign Trade Barriers report from USTR, https://ustr.gov/sites/default/files/files/reports/2017/NTE/2017%20NTE.pdf (Canada pages 65-72; China pages 77-96; EU pages 139-184; India pages 201-218; Indonesia pages 219-238; Japan pages 243-258; Korea pages 275-288; Malaysia pages 297-302; Mexico pages 303-310; Switzerland pages 409-412; Taiwan pages 413-420; Thailand pages 421-430; Vietnam pages 463-472). China is more fully reviewed in the 2016 Report to Congress on China's WTO Compliance, https://ustr.gov/sites/default/files/2016-China-Report-to-Congress.pdf. China, the European Union, India, Indonesia, Korea, Malaysia, Mexico and Taiwan are also reviewed in the 2014 Technical Barriers to Trade Report from USTR, https://ustr.gov/sites/default/files/2014%20TBT%20Report.pdf, which contribute to the deficit the U.S. runs with each of these countries or customs union.

China is the poster child for creating wide ranging adverse effects from domestic policies including: (1) state planning and massive subsidization and the resulting massive global excess capacity that handicaps U.S. and global producers of a wide range of products from steel, aluminum, tires, paper and many others (*see* Global Excess Capacity and Chinese Policies – a Heavy Weight on the Global Economy, http://www.stewartlaw.com/Article/ViewArticle/1076); (2) forced technology transfer which results in loss of competitiveness and often transfer of such technology to other entities; (3) other WTO-inconsistent practices such as export duties and quotas that violate China's protocol of accession for literally hundreds of products, often products where China has a significant share of global production, with the result of having foreign producers shift downstream production to China to obtain artificially low prices within the Chinese market (*e.g.*, rare earth minerals)(*see* Implications of a U.S. WTO Challenge to China's Continuing Use of Export Duties, http://www.stewartlaw.com/Article/ViewArticle/1075); (4) the role of state-owned and state-invested enterprises, government favoritism and other practices that distort market access in China and competition internationally; (5) lack of meaningful labor rights for workers in China and the distortions that flow from competing with products produced with such labor; (6) exporting characterized by massive dumping and supported by massive subsidization and other internal distortions. The materials being provided to the Commerce Department in connection with its review of whether China remains a non-market economy in the aluminum foil antidumping case (submissions due May 10, 2017) will likely provide a great deal of additional information on the distortions in the Chinese economy and their effect on U.S. exports and on U.S. industries. All of these factors have led to the dramatic explosion of the trade deficit with China.

Consider that of the 1,170 antidumping cases filed by various World Trade Organization (WTO) members against imports from China over the last twenty-one and one-half years, 82.0% of these cases were in six of the twenty-one product categories tracked by the WTO:

- 332 cases (28.4%) involved base metals and articles of base metals
- 224 cases (19.1%) involved products of the chemical or allied industries

- 140 cases (12.0%) involved machinery and mechanical appliances, electrical equipment, TVs and similar products
- 90 cases (7.7%) involved textiles and textile articles
- 91 cases (7.8%) involved plastics and articles thereof or rubber and products thereof
- 70 cases (6.7%) involved articles of stone, plaster, cement, asbestos, glass and glassware

Significant cases have also been brought on paper products, wood products, and motor vehicles and parts (total of 80 cases or 6.8%).

Typically, these cases have been characterized by imports from China into the U.S. (or other countries) that rose rapidly and were at prices often below the cost of raw materials. There have been large numbers of countervailing duty cases brought in the U.S. and in other countries as well against the Chinese subsidized exports, and there is pending an important case at the WTO that the U.S. has requested consultations on with China on subsidies to the unwrought aluminum production in China. DS519, China- Subsidies to Producers of Primary Aluminum (12 January 2017).

U.S. imports of HS 4011, new pneumatic tires, from China have generated a trade deficit for the U.S. of from $2-4 billion/year during the 2012-2016 period; steel mill products (imports of which from China are subject to many antidumping and countervailing duty orders) up to $1.6 billion/year; steel pipes and tubes and other articles of steel, up to $9.8 billion/year; plastics up to $9.6 billion; glass and glassware up to $2.4 billion; paper and paperboard, up to $2.4 billion/year. These and many other sectors are known to have been the recipients of large subsidies and to have been highly disruptive in trade in the United States and elsewhere. *See* Exhibits 3 and 4 to this submission. Many of the downstream products that use steel, aluminum, glass, plastics and other products have also shown massive increases in exports driven in significant part by distorted prices and government intervention/support. *See, e.g.*, HS 84, 85, 87, 88 in Exhibit 3.

Responses to selected questions posed in the Federal Register notice (82 FR 18,110)

(a) Assess the major causes of the trade deficit.

Differential tariffs and non-tariff barriers as reviewed previously clearly contribute to the trade deficit that the U.S. runs with each of the countries identified and with the European Union. Government subsidization is most pronounced in the deficits run with China but is not unimportant for other countries; India has broadly available export subsidies; Vietnam has significant subsidies in certain sectors (*e.g.*, farm raised seafood); Indonesia has significant subsidies in certain sectors as well (*e.g.*, paper and paperboard); Canada in certain sectors such as softwood lumber, etc. Dumping has been widespread out of China and to a lesser extent out of Vietnam. For other countries, dumping has contributed in certain sectors and often is a reflection of global excess capacity (frequently triggered by actions by China and/or other identified countries, as the waves of steel cases in the U.S. and around the world would demonstrate in the last few years).

(b) Assess whether the trading partner is directly or indirectly imposing unequal burdens on, or unfairly discriminating in fact against, the commerce of the United States by law, regulation, or practice and thereby placing the commerce of the United States at an unfair disadvantage.

The nontariff barriers identified in the earlier sections and in the various USTR reports all essentially discriminate against U.S. goods (they typically will discriminate against other imported goods as well). The tariff differentials are generally the result of rounds of trade negotiations and the historical focus by the U.S. on Europe, Japan and other developed countries with the result that tariff commitments of many countries (including many of those with which the U.S. runs a large trade deficit) are substantially higher than those of the United States. Such tariff differentials certainly place U.S. goods at a competitive disadvantage vs. products produced in those other countries.

(c) **Assess the effects of the trade relationship on the production capacity and strength of the manufacturing and defense industrial bases of the United States**.

There is little doubt that the persistent and growing trade deficit has resulted in many industries ceasing operations in the United States or U.S.-based capabilities declining significantly. As reviewed in a firm posting last year:

> Tens of thousands of factories have closed and many have moved to countries with lower wages over the last twenty years. While changes in technology and productivity improvements contribute to changing manufacturing profiles and jobs across the country, there is no doubt that many industries have been lost to import competition and others have simply shifted production to countries like Mexico, China, Vietnam or others with much lower wage structures. *See, e.g.*, Ed Schultz, The Ed Show, MSNBC, April 17, 2015, http://www.msnbc.com/the-ed-show (segment titled *Hillary Clinton breaks silence on TPP*) stating that trade deals have closed 50,000 plants (accuracy has been challenged by others as to percent attributable to trade deals). The plant closings are net closings as the data sources used include factories added because of new products, new investment, and expanded exports. *See also* Public Citizen, *Resources to Track Trade-Related Job Loss for Your State and District*, http://www.citizen.org/documents/manufacturing-job-loss.pdf ("Nearly 5 million U.S. manufacturing jobs – one out of every four – have been lost since implementation of the North American Free Trade Agreement (NAFTA) and the World Trade Organization (WTO). Since NAFTA took effect, more than 55,000 American manufacturing facilities have closed.")

Rethinking U.S. Trade Policy – Lessons from the Current Presidential Campaigns, http://www.stewartlaw.com/Article/ViewArticle/1064.

The Commerce Department has two investigations ongoing under Section 232 of the Trade Expansion Act of 1962 into the national security implications for the United States of imports of

steel and aluminum. *See, e.g.*, Imports of Steel into the United States and their Effect on National Security, http://www.stewartlaw.com/Article/ViewArticle/1103. Certainly limitations on existing manufacturing capabilities of the core materials for the building of planes, tanks, ships, other equipment and armaments are directly related to national defense and the security of the homeland. The loss of key technologies, such as the processing of rare earth minerals for a wide variety of uses, can be viewed as threatening national security. *See* Rare Earth Minerals and 21st Century Industry, Hearing Before the House Committee on Science and Technology Subcommittee on Investigations and Oversight,111th Cong., 2d Sess., Serial No. 111-86 (March 16, 2010). Similarly, control over high technology products is critical, whether electronic components such as semiconductors, semiconductor equipment, telecommunications equipment, or other critical components and parts to our weapons systems, our defense systems, etc. In January 2017, President Obama's Council of Advisors on Science and Technology ("PCAST") issued a report, entitled ***Ensuring Long-Term U.S. Leadership in Semiconductors*** which contained a number of recommendations for action to secure the U.S. semiconductor industry. *See* China's Threat to the Competitiveness and Security of the U.S. Semiconductor Industry; Tools Available for the U.S. Government and Industry to Respond, http://www.stewartlaw.com/Article/ViewArticle/1088.

Again, in the past, the U.S. has conducted 232 investigations on antifriction bearings, on nuts and bolts, on ceramic packaging for semiconductors and various other products. Many of these products when imported have been subject to antidumping and/or countervailing duty orders. Some or much of the capacity in these industries has either closed or moved offshore.

(d) Assess the effects of the trade relationship on employment and wage growth in the United States.

Trade can and does have both positive and negative effects on many aspects of the U.S. economy. While less expensive imports can lower costs to consumers and for producers (buying input items), to the extent trade deficits are generated with resulting job losses and/or downward pressure on wages, there are also significant adverse effects. While there are certainly job losses that occur based on technology advances/automation, the trade deficit in goods equates to a loss of some 4.2 million jobs in 2016 (using the USDOC figure for job creations from $1 billion in exports for 2014). Since the countries and the EU being examined account for more than 100% of the 2016 trade deficit, it is fair to say that in 2016 the U.S. deficit with these trading partners resulted in the U.S. having some 4.2 million fewer manufacturing and agriculture jobs than we would have in an environment of balanced trade. Overall, household incomes have been stagnant in constant dollars (indeed down some 10%) since the 1970s. The trade deficit and concern about factories moving away have contributed to such declines and stagnation. Rethinking U.S. Trade Policy – Lessons from the Current Presidential Campaigns, http://www.stewartlaw.com/Article/ViewArticle/1064.

(e) Which bilateral trade deficits are structural or cyclical rather than mercantilist-driven?

(1) Canada – the trade deficit with Canada has swung from a low of $12.1 billion in 2016 to a high of $76.4 billion in 2005 during the 1996-2016 period. Part of the deficit is cyclical based on oil prices (the trade deficit with Canada in HS 2709, petroleum oils and oils from bituminous minerals, crude, from Canada ranged from $9.9 billion in 2001 to $71.6 billion in 2014 before dropping $40 billion to $31.6 billion in 2016). But part of the deficit could be corrected with the addressing of nontariff barriers in Canada (*e.g.*, agricultural products, through addressing dumping and subsidization of softwood lumber and small commercial jets, through modification of U.S. tax laws and policies for motor vehicle production and parts production (U.S. trade deficit with Canada in HS 8703, motor cars and other motor vehicles designed to transport people, ranged between $14.1 billion in 2009 to $32.1 billion in 2012 and $31.1 billion in 2016).

(2) China – the deficit flows from the wide range of distortions to their economy and to the mercantilist policies employed by China.

(3) European Union – the growing trade deficit with the EU is alarming as it is not cyclical to any extent, is broad based in terms of growing deficits with many members of the EU and is concentrated in areas where the U.S. has historically had significant competitive strength. There are certainly some important areas where subsidies and dumping may be factors or where regulatory burdens in Europe may hinder access and a host of nontariff measures where progress should shrink the deficit. Moreover, it is unclear the extent to which distortions from China are reflected in European products that incorporate Chinese inputs. Still, it is likely that some part of the growing deficit reflects need for domestic adjustments to policies, including lifetime education/training, improved infrastructure, tax reform, and some regulatory review/revisions.

(4) Japan has had a long term surplus with the United States and the majority of the surplus flows from the motor vehicle and parts sectors. Many Administrations have focused energy on trying to open up the Japanese market for U.S. vehicles and parts with virtually no meaningful progress. Japan has the lowest foreign direct investment of any advanced economy and its companies appear to deal to a very large extent with Japanese companies (or transplants). There are very large tariff and non-tariff barriers in agricultural goods and a great challenge to overcoming nontariff barriers in non-agricultural goods. Japan should be encouraged to balance the trade relationship through further investment in the U.S. in key sectors like motor vehicles and parts. *See* Moving Our Trading Relationship with Japan Forward, http://www.stewartlaw.com/Article/ViewArticle/1102.

(5) Korea has an FTA with the U.S. However, there are some issues in the FTA that have caused concern, and the U.S. is seeing a growing trade deficit with Korea following the FTA, much of which is tied to motor vehicles and parts with similar problems of access in Korea to those experienced in Japan by U.S. companies. *See* Four Years After the

U.S.-Korea FTA – Trade Myths vs. Trade Facts, http://www.stewartlaw.com/Article/ViewArticle/1065

(6) Mexico – the U.S. had a trade surplus with Mexico in 1994 (the year NAFTA was approved) of $1.3 billion which turned into a trade deficit of $15.4 billion in 1995. The deficit has grown to $63 billion in 2016 as both U.S. exports to Mexico and U.S. imports from Mexico have increased many fold. As noted in the first section, Mexico maintains a 16% VAT on many goods which applies to imports and is rebated on exports. Addressing the disparity between U.S. and Mexican indirect taxes during any renegotiation of NAFTA would be an important first step to addressing the deficit. Second, over 76% of the 2016 U.S. deficit with Mexico is attributable to three 4-digit HS codes – 8704, motor vehicles for the transport of goods; 8703, motor cars and other motor vehicles designed to transport people (other than public-transport type), including station wagons and racing cars; and 8708, parts and accessories for tractors, public-transport passenger vehicles, motor cars, goods transport motor vehicles and special purpose motor vehicles. The Administration needs a game plan to address the elements of competitiveness that will encourage a rebalancing of trade flows in motor vehicles and parts (tax reform, regulatory issues, infrastructure, training, etc.). Non-tariff barriers and some unfair trade practices in certain agricultural products (including subsidies to the fruits and vegetable producers) should also be effectively addressed.

(7) Switzerland – while there are high agricultural tariffs and various nontariff barriers which reduce U.S. exports to Switzerland, the trade deficit the U.S. ran with Switzerland in 2016 appears aberrational. There has been a goods deficit with Switzerland for the 2013-2016 period, largely due to medicines (HS 3004), with trade surpluses for the U.S. for the previous seven years.

(8) As reviewed in earlier sections, for most other countries subject to this study, there are a range of tariff and nontariff barriers that are responsible for part or all of the deficit.

(f) To what extent are non-market economies operating within a market-based system create trade imbalances?

For both China and Vietnam, there is no question but that the vast majority (if not the entirety) of the trade deficits incurred by the U.S. with those countries comes from the many distortions created by the governments of those countries and reflected in the non-market economies of both.

(g) To what extent does chronic industrial overcapacity resulting from government subsidies affect the U.S. trade deficit?

U.S. trade data can help identify some part of the effect on the U.S. trade deficit flowing from overcapacity. However, the true extent is not presently calculable as excess capacity leads to growing exports of the product in excess supply and both destroys U.S. companies and jobs in the immediate sector, reducing production, employment, shipments and exports, but also can lead to significant displacement downstream and create a domino effect as excess capacity in one

country affects trading patterns of other countries which in turn harms U.S. companies and their workers. Nor are there ways at present to estimate the effect of exports of downstream products to third countries for incorporating into products which in turn affect U.S. domestic production, shipments and exports. So while the direct effect is certainly significant, the total effect would probably be shocking.

(h) Have free trade agreements contributed to bilateral trade deficits and how?

U.S. free trade agreements have varied in their effects on trade balances with individual countries. Within NAFTA, our trade deficit with Canada was $14 billion in 1994 and was $12.1 billion in 2016 (though had been as high as $76.4 billion during the period because of volatility in oil/gas prices). Conversely we have gone from a trade surplus with Mexico of $1 billion in 1994 to a trade deficit of over $63 billion in 2016. The FTA with Korea has seen an increase in the trade deficit in the time the agreement has been in place. However, other FTAs that the U.S. has entered have shown improving trade balances. Singapore, Australia, and Peru would be a few examples. In all cases, the FTAs have spurred overall levels of trade. Growing deficits are problematic only if, overall, the United States domestic and trade policies aren't permitting overall balance or reciprocity in trade flows. Causes of growing deficits following FTA agreements can simply be differences in growth rates, failure of a trading partner to implement its obligations in a timely and full manner, domestic hurdles that slow export growth including tax and regulatory policies, etc.

(i) To what extent have weak enforcement and dispute resolution mechanisms inadequately addressed trade issues that result in trade deficits?

Weak enforcement can have to do with inadequate resources at U.S. agencies or international organizations, constructions of rights and obligations which renders relief untimely and hence results in ceding of technological leadership or loss of manufacturing competitiveness. Dispute resolution mechanisms can obviously both aid in achieving national objectives and obtaining the rights agreed but can also result in decisions which reduce the viability of rights and the ceding of competitive industries to others. Moreover, a dispute settlement system that becomes unmoored from an international institution's ability to deliver updated rules and meaningful negotiated results risks spinning into irrelevance. While many countries have applauded the WTO dispute settlement system, the system has a flaw that national systems don't – an inability to correct erroneous decisions by a panel or Appellate Body through the WTO members. The result is that, at least with regard to trade remedy laws such as the antidumping law, the countervailing duty law and the safeguard law, U.S. rights have been significantly eroded over the last twenty years as the Appellate Body has adopted a mode of interpretation that essentially has the Appellate Body making up member obligations as they go in these areas. Without an ability to achieve correction through negotiations or otherwise, the U.S. has lost the ability in many cases to achieve sound enforcement of negotiated rights, costing the U.S. jobs and companies and adding to the U.S. deficit. *See, e.g.,* Terence P. Stewart and Elizabeth J. Drake, How the WTO Undermines U.S. Trade Remedy Enforcement (paper prepared for Alliance for American Manufacturing; February 2017); The WTO Needs to Focus on the Underlying Causes of Unfair Trade Rather than Undermine Legitimate Trade Remedy Laws,

http://www.stewartlaw.com/Article/ViewArticle/1079; Improving the Functioning of the World Trade Organization Appellate Body – the United States makes an important contribution by taking a stand on when reappointment of an AB member is inappropriate, http://www.stewartlaw.com/Article/ViewArticle/1074; The Dispute Settlement System at the World Trade Organization – Is the Current Approach to Settling Disputes Contributing to the Inability to Conclude Broad Multilateral Trade Negotiations, http://www.stewartlaw.com/Article/ViewArticle/1069.

(j) **With regard to manufacturing and the defense industrial base (with specific focus on electronics, aerospace, avionics, materials, machinery, and equipment), comments may address how the following requirements or practices of trading partners have affected opportunities for increased U.S. exports, profitability, and employment: mandated coproduction and licensed production; mandated subcontracting, counter trade; required technology transfer; required collaborative research and development; mandated joint ventures and intellectual property transfer; and required capital investments.**

A number of our trading partners have used co-production of military aircraft as a means of obtaining technology and developing a domestic industry. This was true with Japan fifty years ago. *See* George R. Hall, R.E. Johnson, Aircraft Co-Production and Procurement Strategy (Rand Corporation, 1967) http://www.rand.org/pubs/reports/R450.html. Thus, while some of the issues identified exist in certain sectors in a number of countries, many if not all of the issues are widespread in China and have both affected U.S. production, exports and employment to date and will going forward. Consider just two of the sectors of importance – aerospace and semiconductors.

On aerospace, much has been studied and written on for the U.S.-China Economic and Security Review Commission. The risks to exports, manufacturing and jobs is more pronounced looking forward than has occurred to date. *See, e.g.*, U.S.-China Economic and Security Review Commission, Press Release, NEW REPORT: Chinese Investment in U.S. Aviation (March 27, 2017), https://www.uscc.gov/sites/default/files/Press%20Release_RAND_Chinese%20Investment%20in%20US%20Aviation.pdf; Chad J.R. Ohlandt, Lyle J. Morris, Julia A. Thompson, Arthur Chan, Andrew Scobell, Chinese Investment in U.S. Aviation, https://www.uscc.gov/sites/default/files/Research/RAND_Chinese%20Investment%20in%20US%20Aviation_FINAL.pdf; Chad J. R. Ohlandt, Implications of China's Aerospace Industrial Policies, Testimony presented before the U.S.-China Economic and Security Review Commission on April 27, 2016, https://www.uscc.gov/sites/default/files/Chad%20J.R.%20Ohlandt_Written%20Testimony%20042716.pdf; Roger Cliff, Chad J. R. Ohlandt, and David Yang, *Ready for Takeoff: China's Advancing Aerospace Industry*, Santa Monica, Calif.: RAND Corporation, MG-1100-UCESRC, 2011 (www.rand.org/t/mg1100); and Keith Crane, Jill E. Luoto, Scott Warren Harold, David Yang, Samuel K. Berkowitz, and Xiao Wang, *The Effectiveness of China's Industrial Policies in Commercial Aviation Manufacturing*, Santa Monica, Calif.: RAND Corporation, RR-245, 2014 (www.rand.org/t/rr245).

On electronics, the January 2017 report from the President's Council of Advisors on Science and Technology, Ensuring Long-Term U.S. Leadership in Semiconductors, lays out the challenges being felt by U.S. semiconductor companies, https://obamawhitehouse.archives.gov/sites/default/files/microsites/ostp/PCAST/pcast_ensuring_long-term_us_leadership_in_semiconductors.pdf. The long quote from the report (pages 7-9) that follows identifies the challenges:

> ***Chinese Industrial Policies***
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> Slowing innovation, changing markets, and rising concentration would be significant challenges by themselves. But Chinese industrial policies aimed at achieving a global leadership position in semiconductor design and manufacturing through non-market means, together with the steady growth in Chinese domestic semiconductor consumption, are now compounding those challenges. Chinese competition could, in principle, benefit semiconductor producers and consumers alike. But Chinese industrial policies in this sector, as they are unfolding in practice, pose real threats to semiconductor innovation and U.S. national security.
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> China's starting position in its quest for semiconductor prowess is well behind that of the United States. Chinese manufacturing of advanced-logic chips is significantly behind the state of the art in the United States, Taiwan, and elsewhere. China has many semiconductor foundry companies, but all are at least one-and-a-half generations behind the state of the art in volume production. In addition, there are currently no domestically-owned memory companies producing at commercial volume in China; all advanced-memory manufacturers in China are foreign-owned. Since the foreign companies have chosen to have no Chinese companies involved as joint venture partners, China is spending significant amounts of capital to develop its own indigenous memory industry. Similarly, China lacks a tier-one semiconductor equipment firm.[7] There is one tier-two semiconductor equipment company in China— AMEC—that makes manufacturing tools involved in the fabrication of semiconductors. The most likely avenue for Chinese growth will be acquisition of global players (or divisions of them) in the United States, Europe, or Japan; Chinese firms have been increasingly active in the acquisition space. China's brightest spot is its fabless semiconductor industry, which is booming. There are close to 400 companies, many of which are growing. But there is a technological gap between China's fabless semiconductor industry and those of other countries; at this time, most of China's fabless companies are focused on the low-end and mid-range parts of the market. Assuming that these companies continue to grow quickly—as they are making tailored products for the China market—that will provide

motivation for foreign-owned fabrication companies to have a presence in China, which in turn may draw foreign-owned equipment makers.

The Chinese government, motivated by economic and national-security goals, has publicly asserted its desire to build a semiconductor industry that is far more advanced than today and less reliant on the rest of the world. After more than a decade of failed attempts to promote its semiconductor industry, in 2014 China promulgated "IC Promotion Guidelines" putting forth a new plan, including revenue targets and technology goals. This plan has been backed by the senior Chinese leaders (including President Xi Jinping according to public reports). One stated aim of Chinese policy is for China to be at an "advanced world-level [semiconductor capability] in all-major segments of the industry by 2030."

China's strategy relies in particular on large-scale spending, including $150 billion in public and state-influenced private funds over a 10-year period, aimed at subsidizing investment and acquisitions as well as purchasing technology. This figure is slightly smaller than the average of $23 billion spent annually on semiconductor mergers and acquisitions (M&A) by all U.S. companies over the past 5 years. Already multiple Chinese-government investments executed by investment firms are enabling this government-directed strategy. Consistent with its industrial-policy tactics in other industries, China also places conditions on access to its market to drive localization and technology transfer, according to public reports.[8] Chinese policy exploits headwinds currently facing semiconductor innovation: if the leading edge is advancing slowly, that makes it easier for China to use industrial policies to get technologically close enough to supplant the innovation leaders economically.

Subsidies

The Chinese government provides a range of subsidies to strengthen domestic production. These subsidies are driven in part by a desire to decrease reliance on foreign suppliers for technologies deemed critical to Chinese national security, and in part by a desire to capture market share for economic reasons. China's subsidies to the semiconductor industry include capital subsidies that encourage foreign companies to locate facilities in China as well as subsidized capital to domestic companies and investment firms to use in the acquisition of foreign companies and technologies. While China's subsidies are largely zero-sum in their impact on foreign semiconductor producers (companies, workers, or both) in the same market segment, they may not be zero-sum to other market participants (whether to participants in other parts of the semiconductor supply chain or to users of semiconductors).[9]

In the short run, Chinese subsidies can benefit U.S. consumers and firms that use semiconductors by reducing costs and lowering product prices. In the long run, however, subsidies to incumbent technologies tend to reduce innovation.[10] Depending on the initial state of the market, subsidies can also increase market concentration in China. This can increase national-security risks for the United States and other countries and, to the extent that Chinese policy allows firms to sell below cost of production, raises risks of overcapacity, which threatens direct competitors. Subsidies also, more directly, can erode U.S. market share, damaging industry employment as well as innovation.

Zero-Sum Tactics

China also employs a variety of tactics that are more broadly and unequivocally zero-sum. These are policies that shift business to China while raising, not lowering, costs. These policies are harmful because they hurt otherwise sound businesses without bringing countervailing economy-wide benefits, raise prices for consumers and other businesses that use semiconductors, and can deter innovation. Such policies also can create defense-related national-security risks by accelerating the spread of sensitive technologies. Chinese zero-sum activities include:

• *Forcing or encouraging domestic customers to buy only from Chinese semiconductor suppliers*. China is doing this both explicitly (e.g., in government contracts) and indirectly (e.g., through its proposals to implement "secure and controllable" requirements relating to cybersecurity concerns). Such practices reduce incentives for innovation across the board: non-Chinese companies see smaller markets, while Chinese companies face less competition. Given the size of the domestic Chinese market, these practices could also result in a high concentration of the global market in China over the longer run.

• *Forcing transfer of technology in exchange for access to the Chinese market*. This practice affects innovation by reducing incentives for R&D, including in the United States (since U.S companies sell into and compete with China), and by quickly turning leading-edge technologies into commodities that anyone can produce. It can also increase market concentration in China; conversely, as Chinese market concentration increases, so does China's ability to force technology transfer, creating a vicious cycle.

• *Theft of intellectual property*. This activity affects innovation in a similar manner to forced technology transfers. According to media reports, China steals intellectual property both covertly and overtly. Overt means using inspections for "secure and controllable" technology to gain access to detailed knowledge of semiconductor technologies.[11]

7 *Tier* one companies are direct suppliers to equipment manufacturers (OEMs). *Tier* two companies are the key suppliers to *tier* one suppliers, without supplying a product directly to OEM companies.

8 See: www.minneapolisfed.org/research/sr/sr486.pdf.

Chinese industrial policy can usefully be divided into two categories: subsidies and zero-sum tactics.

9 Zero-sum tactics are those where one entity's gain is equivalent to another's loss, where instead of growing overall value, entities are taking from each other.

10 See: economics.mit.edu/files/8790.

11 See: www.nytimes.com/2016/05/17/technology/china-quietly-targets-us-tech-companies-in-security-reviews.html.

Conclusion

The review being undertaken by the U.S. Department of Commerce and the U.S. Trade Representative is an important step in understanding the challenges U.S. companies and their workers face in achieving reciprocal benefits in fact from the liberalized trading order that the United States has helped create over the last seventy years. Coupled with a review of domestic policy changes that will address improved competitiveness, the review should identify issues that need to be addressed in the trade arena to benefit American producers and their workers.

Sincerely,

/s/ Terence P. Stewart

Terence P. Stewart