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HAMILTON CENTER ON INDUSTRIAL STRATEGY

How to Mitigate the Damage From China's Unfair Trade Practices by Giving USITC Power to Make Them Less Profitable

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Section 337 of the 1930 Tariff Act allows the U.S. International Trade Commission (USITC) to bar imports when domestic industries suffer harm due to unfair competition. Congress should expand the law to better address the unfair trade practices China uses to capture market share in advanced industries at America's expense.

KEY TAKEAWAYS

- Existing strategies to counter China's industrial predation—including trying to make it change its policies, boosting U.S. competitiveness, or limiting China's access to U.S. resources—are not viable or likely to be effective enough on their own.
- Reforming Section 337 can change the game by making unfair trade practices less profitable: When China violates global rules or norms to benefit particular firms, they would be denied access to U.S. and (ideally) allied markets.
- Over the last several decades, Section 337 has been largely used to adjudicate patent disputes, often among U.S. multinationals—but it can and should be used to address other trade practices from non-market, non-rule-of-law nations.
- Congress should reform Section 337 to, among other things, make it easier to impose exclusion orders against imports from companies systematically supported by unfair trade practices in non-market, non-rule-of-law economies such as China.
- Congress should allow the Commerce Department to bring cases before USITC and provide more resources to thoroughly document and adjudicate Chinese unfair practices, and the administration should work with allies to establish similar programs.
- This will not only send a clear message of support for free trade, but also enable allied-nation firms to compete more effectively with Chinese government-backed champions.

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INTRODUCTION

The last decade has seen a growing consensus that China's economic, trade, and technology policies and practices pose a significant threat to U.S. economic and national security. For the most part, the debate is no longer about whether China poses such a threat, whether its practices affecting trade and investment are mostly legitimate, or whether China is getting in line with its World Trade Organization (WTO) obligations. The new Washington consensus is that China is a threat, Chinese government trade policy actions are mostly unfair and predatory, and it is moving away, rather than toward, its WTO obligations.

This means the policy debate has moved from the question of whether there is a problem to what the response should be. There are two main camps. The first—call it the "speed us up" camp—holds that there is little America can do about Chinese policy, other than perhaps bring a few more WTO cases, so Washington should focus on boosting U.S. competitiveness to stay ahead of China. But while a robust competitiveness agenda is certainly needed to bolster America's advanced industries, it will ultimately be insufficient by itself, even if Congress could overcome resistance to putting in place a truly effective policy.[1]

The second view—the "slow China down" camp—holds that unless the United States takes effective action to "throw sand in the gears" of China's innovation and production system, even the best domestic actions will not be enough to avert serious erosion of America's competitive position in advanced industries.

These two camps represent different policy approaches, but they are not mutually exclusive. America can and should simultaneously bolster its industrial competitiveness while employing countermeasures to thwart China's economic aggression—as the Information Technology and Innovation Foundation (ITIF) has advocated extensively—although there are challenges on both fronts. When it comes to enacting a robust competitiveness agenda, they include political ideology and economic doctrine—subjects ITIF has addressed in other reports. And when it comes to thwarting China's aggressive innovation mercantilism, the problem is one of practical reality and political will. That is the focus of this report.

Until recently, most in the "slow China down" camp believed that the United States should do more to impose "pain" on China (through either multilateral or unilateral means) to pressure its government to roll back its destructive and predatory trade and economic policies. Such a unilateral strategy might have worked 15 years ago, but as the limited results of the Trump administration's efforts showed, China is too powerful now to be swayed by any actions the U.S. government can take on its own. China's "mind is made up" to double down on its "Made in China: 2025" program. Meanwhile, a multilateral strategy has not been possible thus far because many U.S. allies, particularly those in Europe, have seen China as an economic opportunity too important to give up, so they and many other nations have been happy to let the United States be the one to challenge China while they have sat back and reaped the rewards.

With the growing recognition that there is in fact little America can do to get China to roll back its innovation mercantilist regime, many have now shifted their focus toward limiting key U.S. inputs for Chinese success, including access to universities, financial markets and capital, foreign direct investment in the United States, and intellectual property (IP). Yet, while many such policies should be adopted, they still would not be sufficient to slow China's encroachment into advanced industries. China will still be "going faster" than the United States.

As such, the federal government needs to embrace an approach that seeks to limit China's ability to profit from industrial predation. In particular, Congress should amend the Tariff Act of 1930 to enable stronger use of the USITC's Section 337 statute, amending it to make it easier to exclude goods and services from China supported by systemically unfair trade practices. Even though the statute was originally envisioned to help address unfair foreign trade practices, Section 337 is generally not seen as a tool to address Chinese industrial predation. Rather, it has evolved into a secondary patent "court" in which multinationals from allied countries bring patent cases, often against each other. Instead, it should be used much more vigorously to prevent the import of products from firms in other non-market, non-rule-of-law economies such as China's that systemically benefit from unfair government policies and practices.

Ideally, U.S. negotiators would work with democratic allies to encourage and help them institute a similar system. The most allied nations can hope for, absent some dramatic leadership change in China, is for China to continue to engage in IP theft and coerced technology transfer, massive subsidies and other predatory practices, and closed markets, but with allied nations not allowing Chinese firms benefiting from those actions to gain access to their own domestic markets.

Time is on China's side because it is making faster progress than the United States is and the particular nature of innovation industries, where increased competitive advantage can lead to tipping points where competitors lose significant market share due to the now-leading firms' advantages in research and development (R&D) and production, characterized by declining marginal costs. We only have to look at the telecom equipment industry and the rise of Huawei and the fall of Ericsson and Nokia to see this process at work. Adding a regime to limit China's foreign gains from unfair trade practices will be critical to keeping key allied industries from reaching this tipping point to decline or extinction.

THE NATURE OF CHINESE INNOVATION MERCANTILISM, ITS EFFECTS, AND POLICY OPTIONS TO THWART IT

Much has been written about unfair Chinese trade, economic, and technology practices, including a 2012 ITIF report "Enough Is Enough: Confronting Chinese Innovation Mercantilism."[2] As such, there is no need for a full review of the "bill of particulars." A later series of ITIF reports examines China's innovation mercantilism across a number of high-tech industries, including biotechnology, semiconductors, telecommunications equipment, solar panels, and high-speed rail.[3] ITIF also has published two reports on how China has failed to live up to the promises it made when joining the WTO.[4]

It is, however, worth mentioning three things. First, most criticisms of China are not of China's increased competitiveness per se. Rather, they are of the means by which China has attained that position based on the accurate view that China's harmful impact on U.S. competitiveness would be significantly less had it complied with its WTO obligations.[5]

Second, for the most part, criticisms of Chinese policies are not grounded in some kind of idealized free-market critique that holds all foreign government industrial policy in derision. The reality is that virtually every country that has sought to move to higher value-added production has adopted some kind of industrial policies.

But China has gone way beyond that. None of "the Asian Tigers" (Hong Kong, Korea, Singapore, and Taiwan) rely on forced technology transfer in exchange for market access. None engage in massive industrial espionage. And while most provide industrial subsidies, none provide them in the scope and magnitude of China's.[6] Moreover, the Tigers are rule-of-law countries where foreign companies have at least some recourse and protection from capricious state action weaponized for domestic industry advancement. In addition, while each nation has some components of "Nation Inc." (e.g., Japan Inc.) where government and business are aligned, the nature of that alignment is vastly tighter and enforced with much more rigor in China. In addition, China is able to mobilize its population as a weapon against targeted foreign companies through organized boycotts.[7] In other words, China stands apart from any other country in history in the extent and nature of its predatory, innovation mercantilist policies.

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Third, China's predatory, innovation mercantilist policies matter, especially because of its size. Some pundits—although fewer these days—will argue that we shouldn't worry too much about Chinese economic and technology competition because America is more innovative and, besides, industrial policy doesn't work. This is wishful thinking. As ITIF's "Hamilton Index of Advanced-Industry Performance" shows, U.S. global market share and industry concentration in advanced technology industries is low, and falling. While advanced industries as a share of America's economy are 6 percent less than the global average (20 percent less when leaving out information technology [IT] and information services), China's share in advanced industries is 34 percent higher than the global average. To match the advanced-industry share of China's economy, U.S. output would have to expand by nearly $680 billion (42 percent). In addition, China's distortionary policies have harmed global innovation by unfairly taking market share from more innovative companies in other nations.[8]

Notwithstanding the neoliberal belief that global trade is generally a win-win proposition, nations are indeed in fierce win-lose global competition for market share in advanced-technology industries because winning that competition—not only the competition for innovation leadership, but also the competition for production leadership—will boost wages and international competitiveness, thereby enabling economic and national security.[9] This is especially the case for the United States, because if it wins, it is likely that its chief adversary (China) will lose, and vice versa. In other words, most of this competition is over a "fixed pie," where if other nations win, especially China, it will mean that the United States is likely to lose, especially as the Chinese government has firmly set its sights on increasing its global market share in all advanced technology sectors. We see this tug-of-war in the fact that there was a strong correlation (-0.78) between the change in the respective shares of global output China and the United States held in advanced industries from 1995 to 2018.[10] In other words, the more ground China gained in these industries, the more the United States lost.

Therefore, if one agrees that advanced industry competitiveness matters to the United States (e.g., computer chips are more important than potato chips), and that China's innovation mercantilist policies contribute in a meaningful way to that loss of U.S. competitive position, there are two main courses of action.

One is to eschew trying to get China to change and instead focusing on getting our own house in order. The Biden administration and many Democrats have embraced this view, putting the focus more on domestic policy, some of it related to competitiveness; but much more it related to social spending and climate change.[11] To the extent there is pressure on China, it is over global issues such as climate change and human rights violations.

The second course of action focuses on limiting China's growth by forcing it to roll back its innovation mercantilist policies. The Trump administration largely embraced this view, using tariffs and other tools to try to pressure China to change its predatory practices. At home, reflecting its embrace of free-market economics, the Trump agenda contained very little to constitute a national industrial strategy to build up American capabilities, especially in advanced industries.

The Difficult History of Trying to Change Chinese Policy

U.S. policy toward China from the 1930s to present has been to try to change China to become more like us. The State Department's "China hands" in the 1930s and 1940s supported Mao over Chiang Kai-shek because it viewed Mao as an agrarian reformer who would make China more of a democracy. President Nixon's groundbreaking trip to China was intended to change China, not only to have it side with America against the Soviets, but to get it to change to become more like us. Two decades later, the Clinton administration pinned its hopes on China changing by championing China's accession to the WTO, believing that it would force China to be more open, democratic, and market-oriented, as when President Clinton said, "It represents the most significant opportunity that we have had to create positive change in China since the 1970's, when President Nixon first went there, and later in the decade when President Carter normalized relations."[12]

While the George W. Bush administration did begin applying some U.S. countervailing duty law against China, overall it did not see China as a serious threat, believing that if anyone were to be a winner, it would be America. Its Commerce Department even went so far as to host workshops to help American companies open up manufacturing operations in China as a way to cut costs and boost their global competitiveness.[13]

However, as the United States lost over one-third of its manufacturing employment in the 2000s—around two-thirds of that due to China—it became clear that America was not the unalloyed winner the Washington DC trade establishment had envisioned.[14] As the economic damage became clearer, the Obama administration gradually came to the conclusion that China was a threat to U.S. economic security. However, with a few exceptions, it relied almost exclusively on exhortation. In multiple dialogues with Chinese officials, the administration explained what it objected to, hoping that China would see that it was also hurting itself and change course. To the extent China did not change, the widely held view was that engaging the adjudication process of the WTO (as well as establishing the Trans-Pacific Partnership trade agreement) was the only legitimate step.

But it wasn't that Chinese officials were not smart or had not absorbed the lessons from Adam Smith's *The Wealth of Nations*. Many Chinese officials had actually read it; they just didn't buy into it. Chinese officials do not subscribe to Anglo-American neo-classical economics. Rather, they are more likely to have read German development economist Friedrich List and studied closely the industrial policy-driven success of Japan and the Asian Tigers. The Chinese

Communist Party (CCP) has made industrial advancement, and ultimately leadership, a top priority and are willing to do virtually anything to achieve it.

The Trump administration was the first to seriously "pull back the curtain" on China, exposing and calling out its rampant innovation mercantilism and using unilateral pressure to try to change China's policy direction, mostly through the imposition of tariffs, believing that only by inflicting pain would China change. While at the margin tariffs likely encouraged some Western companies to adopt a "second source strategy" (opening up additional production capabilities outside China in places such as Vietnam), they were wholly ineffective at getting China to change course.

That pressure failed to change China's approach for a number of reasons. Because China not only imposed tit-for-tat tariffs on U.S. goods but also devalued their currency, its overall export performance did not suffer, while America's did. In fact, the U.S. trade deficit with China actually increased from $346 billion in 2016 to $353 billion in 2021 and is now at record levels.[15]

Placing modest tariffs on some Chinese exports is like Kyle Reese throwing sticks of dynamite at Arnold Schwarzenegger's *Terminator*: It will do nothing to deter them.

The Trump administration also imposed export controls, particularly for certain advanced technology inputs, but with a few exceptions, this largely encouraged China to buy from U.S. competitors or spur their own indigenous development efforts. If anything, the Trump administration export bans and tariffs were a "Sputnik" moment for the CCP, accelerating its course to decouple technologically from the West. (Although, to be clear, China already held this goal, and while the Trump administration's export bans might have accelerated this, in no way did it initiate the technology decoupling, autarky-seeking policies China had already embarked on.)

President Trump also weakened his hand by asking China to bring down the trade deficit by buying more U.S. farm exports, rather pressuring China to roll back its predatory policies.

As aggressive as the Trump administration's actions were, they failed to change China's policies or its trajectory of advanced industry competitiveness. As long as President Xi, or his allies in the CCP, are in power, they will not be deterred from what they see as their historical mission to once again become the most powerful nation on earth. Placing modest tariffs on some Chinese exports is like Kyle Reese throwing a few sticks of dynamite at Arnold Schwarzenegger's *Terminator*: It will do nothing to deter them.

Moreover, as long as the United States acted unilaterally, China could ignore pressure because it could largely get what it needed from other countries, and in the process gain allies (or at least buy off potential critics). Indeed, the very framing of this conflict as the "U.S.-China trade war" played into the hands of China and putative U.S. allies. China could obtain the moral high ground, actually claiming that it was the free trader and defender of globalization, as Xi had the temerity to do at Davos in 2017.[16] And many in the West fell for this propaganda, as reflected in a *New York Times* story titled "In Era [*sic*] of Trump, China's President Champions Economic Globalization."[17]

Europe, in particular, portrayed the United States as a global trading rogue, all the while rushing to sell China as many cars, bottles of wine, and machine tools as it could. To wit, Anton Boerner, head of the German BGA trade association, couldn't wait to take advantage of America's challenge of China's unfair practices (something that, if successful, would help Germany), stating, "Given the protectionist plans of the new U.S. president one would expect that the trade ties between Germany and China will be further strengthened."[18] And indeed they were. Whatever one thought of President Trump's tariffs (ITIF generally opposed them), the reality is that they were not put in place to protect American industry, but to pressure China to start playing by the rules, something that would benefit all nations except China.[19]

But many leaders in Germany and other nations that had previously been trekking to Beijing on export missions now see that perhaps China was not the rosy prospect they had once envisioned. They can see the handwriting on the wall, that China wants to replace their industries and firms with its own. So perhaps it might be possible for the Biden administration to craft a "coalition of the willing" that would collectively exert pressure to convince China to roll back its innovation mercantilist regime.

If such a coalition were put in place in the early years of the Obama administration, when China was less advanced in key industry and technology capabilities, it might have had the leverage to change internal Chinese policy. But it is likely now too late. China has gained considerable advanced technology sophistication and global market share since the early 2010s to the point where it could threaten individual nations with economic harm should they consider banding together under a U.S. umbrella. On top of this is the challenge of getting enough countries to join in. While some countries, such as Australia, Japan, Taiwan, and the United Kingdom, appear that they might be willing to join such an effort, India, South Korea, and many EU nations would likely prefer to stay on the sidelines. China has bought off or threatened many nations into submission, including through its "wolf warrior" diplomacy (where its foreign ministry officials bludgeon foreign nations with aggressive rhetoric). As such, many countries will think twice before joining America, especially given the lack of steady leadership in both past and current U.S. administrations and the deeply divided domestic American political situation.[20] As such, the ability of democratic states to work collectively to pressure China to roll back its innovation mercantilism is likely lacking, absent some provocative act such as the invasion by China of Taiwan.

Limits of the World Trade Organization

If multilateral action is not likely, what about the WTO to get China to change? Those committed to the post-war global order balk at the idea of adjudicating international trade conflict outside the rules-based order of the WTO. This is a laudable spirit in that it limits actions that nations claim to be using to fight unfair trade protection, but are, in fact, domestic protectionism. The problem is that the WTO is not set up in a way that can stop, or even roll back, China's abuses of the global trade order.[21]

This is true for at least four main reasons. First, the WTO is set up to adjudicate rules that are embodied in law and regulation, and even then, it often has a hard time achieving real results, as it has no authority to impose punishment. Chinese government officials fully understand WTO arcana and work to ensure that their mercantilist practices escape scrutiny and prosecution. Take two examples. In direct violation of WTO rules, China forces many foreign companies to transfer technology to Chinese firms as a condition of market access.[22] However, Chinese officials know better than to codify into law or regulation these requirements, which make it almost impossible to win a case before the WTO. Another example is state subsidies. Rather than channel subsidies to national champions directly from government, which is more likely to be seen as a violation of trade agreements, China launders money through supposed private sector players, calling it private sector venture investing.[23]

Second, much of what China does is outside the scope of WTO rules. For example, in theory, the WTO can adjudicate export subsidies, but most of China's subsidies are more opaque and harder to prosecute, such as free land and electricity, low-interest forgivable loans, government-backed equity, and even domestic production subsidies. While respect for patents and other IP covered by the Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement, China's rampant commercial espionage, both through human agents and cyber means, is almost impossible to adjudicate.[24]

Third, as it stands, few governments will bring WTO cases without the support of relevant companies in their jurisdiction, in large part because trade agencies rely on company information. China is fully aware of this vulnerability, which is why it routinely threatens foreign companies with retaliation should they bring cases. The situation is akin to a city controlled by the mafia where individuals will not come forward to the police because they know they will not be protected from mob retribution. For example, in 2012, when the EU trade minister sought to bring a WTO case against China regarding illegal subsidies given to its telecom giants Huawei and ZTE, he quickly withdrew the proposal after complaints from the Swedish government (which was likely pressured by its telecom champion, Ericsson). Ericsson was presumably told by the Chinese government that if a case were to go forward it would see Ericsson's market share in China dramatically cut.[25] U.S. firms with operations in the Chinese market know that if they ask the United States Trade Representative (USTR) to bring a WTO case against China they will face retaliation in China.

The WTO is no longer—if it ever was—an institution that can require China to comply with global trade laws and norms.

Finally, the nature of the organization, with its requirement for unanimity, makes it virtually impossible to reform WTO rules to make it more effective against China's brand of innovation mercantilism, because China and the allies it pressures into subservience will vote against needed institutional reforms.[26] China has penetrated the organization's leadership and pressured or "bribed" many WTO members to take its side, in part by promulgating the myth of developing country victimization. More broadly, the WTO was never designed to deal with a non-market country with the size and power of China. The rules were designed for comparable economy market competition, and the unfair trade rules would prevent occasional distortions (e.g., occasional dumping and subsidies).

In other words, the WTO is no longer—if it ever was—an institution that can require China to comply with global trade laws and norms.

Chinese Foreign Minister Wang Yi said that the United States should stop its "wishful thinking" of trying to change China.[27] He is right: The United States cannot do much to pressure China to end its economic predation and roll back its innovation mercantilism. That is indeed wishful thinking.

Speeding America Up Is Necessary But Not Sufficient

Given that U.S. efforts to get China to roll back its innovation mercantilism are not likely to succeed, many have thrown up their hands and focused instead on what the U.S. government can control: domestic policy. Former Democratic administration economic official Larry Summers exemplified this that view when he stated:

> I walk back from the path of confrontation and competition over who can be harsher towards China, to a policy that is grounded in an accurate assessment of U.S. economic interests, and therefore more modest in its attempt to transform China, and more ambitious in its attempt to build alliances with our natural allies, and to strengthen our productivity, and economic strength more broadly in the United States.[28]

Former Assistant Secretary of Defense Chas Freeman agreed:

> Our politics are polarized and dysfunctional … our social fabric is fraying, our international prestige is declining, and we are more divided internally than at any times since our civil war. We appear to have achieved herd immunity to strategic reasoning. We pay lip service to the need to reinvigorate our economy and its technological advance, but in practice focus instead of on hamstringing China. This is equivalent to smoking pot in a hot tub, and fantasizing about tripping up our competitors in track events when they are out training and trying out new equipment.[29]

There is much to be said for the view that Congress and the White House should focus more on building America's competitive position, especially in advanced industries. ITIF has laid out the components of a national advanced industry strategy.[30] Some of these ideas, and others, are in the CHIPS (Creating Helpful Incentives to Produce Semiconductors) and Science Act, an important legislative achievement. But while the act was an important step forward, it's not clear if provisions will be fully funded, either this year or in years to come, particularly as Democrats push for higher levels of social spending and Republicans for even more tax cuts, all while the national debt soars.

Moreover, the CHIPS and Science Act is only one of many steps that will be required to restore American advanced industry innovation and production leadership. The R&D tax credit rate needs to, at minimum, be doubled.[31] Congress needs to pass a "super-CHIPS" Act to provide incentives for industries beyond semiconductors.[32] Congress needs to establish and fund a patient debt capital program for scaling industrial production (e.g., the Senate proposal for an Industrial Finance Corporation), ideally in concert with laws and regulations reforming the U.S. financial system so that it prioritizes long-term investment in national interest priorities instead of short-term profit making.[33] Congress needs to boost STEM (science, technology, engineering, and math) immigration and expand even further public-private advanced R&D partnerships. It should put in place an investment tax credit for machinery, equipment, and software.

But these kinds of additional steps may be difficult to take, especially given the intense partisan bickering in Washington; the extreme ideological divides between libertarian free marketers who oppose anything that smacks of "industrial policy" and progressive redistributionists who oppose anything that helps companies with more than a handful of workers or that are not focused on clean energy. In addition, the disdain toward industry and sectoral policies held by most economists, analysts, and pundits in Washington makes it almost impossible to have a balanced, objective conversation about these policies. Finally, there is America's massive national debt, which makes big new expenditures (direct or tax) extremely unlikely.

Finally, even if by a miracle the United States develops and fully funds the most sophisticated industrial policy among democratic nations, that is likely not going to suffice. No matter how sophisticated a company is, and how low the taxes it pays are, it is hard to compete against a Chinese competitor that has a lock on the vast and growing Chinese market (and increasingly, "Belt and Road" country markets), and is backed with a government-provided war chest that can underprice its market-based competitors for a very long time, and to a very large degree.

This gets to the strategy three: working to limit China's foreign inputs to its innovation machine.

The Limited Prospects of Limiting Inputs for China's Innovation Economy

In recent years, discussion of China economic and trade policy has focused more on steps to limit China's gains from U.S. actions. Emblematic of this was the passage of the Foreign Investment Risk Review Modernization Act (FIRRMA), which made it harder for Chinese-owned companies to invest in the United States, something they did regularly in order to obtain and then transfer technology assets (although the provisions still need to be tightened to take in investments with Chinese minority ownership). The Trump administration raised the awareness of the risk of some Chinese students studying at U.S. research universities obtaining and illegally transferring technology to China. There is new attention being paid to limiting U.S. capital investment into China, including by government pension funds, Wall Street, and venture capital firms. ITIF has written about stopping state and local governments from providing financial incentives to Chinese firms.[34] Congress is debating legislation to require certain U.S. companies to get approval before making direct investments and technology transfers in China. There are regular discussions and increasing efforts to limit Chinese theft of IP through either cyber or physical means. And some have called for programs to promote "friend-shoring" or reshoring of production from China.

Many of these measures, including limiting federal programs such as the Small Business Innovation Research Program so that it does not benefit Chinese firms, make sense.[35] Others, such as significant decoupling, do not now but likely would end up hurting U.S. firms and workers more than it helps them. Cutting off sales of nonsensitive products to China only hurts the U.S. economy. Unless they are designed with appropriate nuance, still others, such as mandated tech transfer notifications and limits on Chinese STEM students and U.S.-China technology cooperation, could backfire and end up actually helping U.S. competitors. Nonetheless, measures to limit Chinese inputs from America should continue to be debated and considered, with appropriate policy changes made.

As helpful as many of these measures could be, some suffer from a number of challenges. First, in many cases, China will simply turn to other nations. If America prohibits Chinese students from studying STEM at U.S. universities, there are many high-quality universities around the world that would jump at the chance of increasing their enrollment of full-paying students. Second, even if these policies do limit some inputs to China, the Chinese government has shown that they will provide vast assistance—most of it unfair—to enable its companies to take market share away from U.S. and other foreign companies. Unless that problem is addressed, little in the way of seriously limiting China and the damage it does to U.S. firms will be accomplished. This leads to the fourth strategy.

A Complementary Strategy: Making China's Innovation Mercantilism Less Profitable in US and Allied Markets

If U.S. government action can't change China's predatory practices, if domestic action is not likely to be enough to ensure adequate U.S. advanced industry production, and if limiting China's inputs is likely to be a partial solution, at best, where does this leave the U.S. government? It leaves it with the choice of limiting the benefits China gains from its practices. This means denying access to the United States and ideally allied markets of Chinese goods based in more than de minimus ways on innovation mercantilist practices. In other words, it is time for the U.S. government, ideally working with allies, to craft and implement a new set of trade defense instruments.

Market-Illegitimate Firms in China

It is difficult for allied nations to stop China from reserving its own domestic (and nearby) market for its national champions, as it has done in a host of industries from telecom equipment to solar panels, and which it plans to do in industries such as pharmaceuticals, aerospace, and semiconductors once it develops adequate industrial capacity. But what nations can do is not let China gain access to their markets for products that benefit significantly from unfair trade practices.

It is time for the U.S. government, ideally working with allies, to craft and implement a new set of trade defense instruments.

Take the case of COMAC (Commercial Aircraft Corporation of China Ltd), the Chinese state-owned aerospace giant seeking to displace Boeing and Airbus in the global passenger jet market. While the Chinese government goes to great lengths to hide the extent of its industrial subsidies, it's clear that COMAC has received extremely sizeable government funding.[36] CSIS China scholar Scott Kennedy estimates that COMAC has received potentially 3.5 times more subsidies than Airbus has received from the European governments. On top of that, Chinese government pressure led General Electric to form a joint venture with COMAC's parent, AVIC, to provide avionics technology.[37] There should be no question that once COMAC works out the bugs and is able to produce a commercially viable plane (its C919 has already undergone test flights and advanced orders have been made by Chinese state-owned airlines), Chinese airlines will be told in no uncertain terms they must buy COMAC, just as Chinese wireless companies are told they must buy from Huawei and ZTE.[38] After that, Belt and Road countries will be pressured and incented to buy COMAC planes. As this happens, Boeing and Airbus sales will shrink, increasing their costs per airplane, given that so much of the costs of any airplane are fixed, not marginal costs. This will in turn shrink their sales even more. At the same time, continued Chinese government subsidies, coupled with ongoing cost reduction from growing scale economies, will enable COMAC to gain even more market share. There is every reason to expect that the industry could one day resemble the telecom equipment industry, in which Lucent and Nortel are out of business, and Ericsson and Nokia have much smaller market shares thanks to Huawei and ZTE. In other words, a world in which COMAC is the largest plane builder, with Boeing and Airbus significantly smaller than they are today.

If market forces were predominant, the C919 would never have been designed or built. No private entrepreneur or company would risk the capital to enter such a well-functioning market with a copycat plane in an industry with high barriers to entry. COMAC is economically illegitimate. Only massive government subsidies, forced technology transfer, and guarantees of domestic sales have enabled it. As such, allied nations should agree that they will not allow any of their domestic airlines to purchase COMAC planes. The result, as previously discussed, would be to hopefully prevent the downward spiral of Boeing and Airbus, while also limiting COMAC's economies of scale.

Blocking imports of such illegitimate products would do two important things. First, it would limit Chinese firm sales, a critical factor in innovation-based industries. This is because most innovation industries are subject to increasing returns to scale in imperfect markets. In these industries, a firm can outcompete its rivals if it gains a modest advantage in price or performance. That initial advantage can grow into a massive one if increased market share and sales enable the firm to more effectively boost innovation or efficiency than its rivals can. As the term implies, the firm gets increasing returns to scale because the marginal cost of each unit of output goes down and innovation goes up. This is because fixed costs are very high in the industry. (COMAC has spent tens of billions of dollars before they have sold a single plane.) Denying COMAC sales of its planes, for example, would mean an increase in average costs and a reduction of its profits to reinvest in its next generation of planes. The opposite effect would occur with Airbus and Boeing, which would see a less dramatic reduction in sales and therefore be able to continue to benefit from scale economies.

There are many other examples of Chinese industries and products that can be considered illegitimate in the sense that they've gained market share through unfair means. Take Huawei, for example, a firm that's enjoyed over $75 billion in government subsidies and benefited from government-forced technology transfer from foreign telecom equipment companies.[39] In addition, Chinese rails cars, many of them bought by U.S. cities using federal funds, are in this category as well, given they are produced by a government-established monopoly that has gained much of its technology from forced technology transfer and received significant government subsidies and sales in a largely closed market.[40] Likewise, Chinese electric vehicle makers receive significant subsidies from their government, as well as benefiting from regulations that pressure foreign electric vehicle makers into transferring technology to Chinese-owned companies.[41]

In addition, China has gained significant global market share in the construction equipment (CE) industry, an industry the Chinese government has identified as strategic. Astrid Pepermans noted that, "prior to 2008, there was not a single Chinese equipment manufacturer listed in the top fifteen of the so-called 'Yellow Table,' … in 2015, three Chinese companies—Zoomlion, Sany and XCMG—respectively ranked number 11, 8 and 6 in the list of the world's largest CE providers."[42] These companies both benefit from reserved markets whereby construction companies are required to buy from Chinese equipment firms and receive similar "reserved markets" in most of the Belt and Road construction projects financed by the Chinese government. These three firms have also received between $240 million and 370 million a year in subsidies from Chinese governments in recent years. China imposes high taxes on imported CE, even though it promised when it joined the WTO that it would lower them. And state-owned banks provide massive debt to these companies, far in excess of what normal private sector lending standards would allow.

Limiting Imports From Market-Illegitimate Firms

Blocking imports would not be needed if U.S. firms and or the U.S. government could successfully bring cases against foreign companies in U.S. court, or relevant international fora. But as noted, when it comes to China, they usually cannot.

If the challenge is limiting imports of Chinese products that benefit from unfair trade practices, then there are at two ways to do this. One way is to institute a Section 301 investigation, as the Trump administration's USTR did, and then impose tariffs on an array of Chinese imports. The problem with this approach is that it uses blunderbuss rather than a rifle shot. The Trump administration tariffs "ranging from 7.5 percent to 25 percent were imposed on approximately $370 billion worth of annual U.S. imports from China back in 2018."[43] But they covered a wide array of products, some that presumably benefited much less, if at all, from unfair trade practices. Moreover, China responded by lowering the value of its currency, offsetting some of the tariff impact.

A more effective way to implement a trade defense strategy would be for Congress to reform Section 337 of the Tariff Act (19 U.S.C. 1337), which prohibits "unfair methods of competition and unfair acts in the importation of articles into the United States," if the effect is to destroy or substantially injure a U.S. industry, or where the acts relate to importation of articles infringing U.S. patents, copyrights, trademarks, or registered mask works.[44]

Congress established Section 337 in the Tariff Act of 1930 to "curb unfair trade practices" that "involve the entry of goods into U.S. markets via importation." That authority was originally based on Section 316 of a 1922 act that gave the U.S. Tariff Commission (the predecessor of the USITC) authority to limit imports. The Senate Report on that bill describes this authority such: "The provision relating to unfair methods of competition in the importation of goods is broad enough to prevent every type and form of unfair practice and is, therefore, a more adequate protection to American industry than any antidumping statute the country has ever had."[45]

Senator Smoot, the act's primary sponsor (of Smoot-Hawley fame), argued that 316 was intended to be "an antidumping law with teeth in it—one which will reach all forms of unfair competition in importation."[46] He went on to note that the section "not only prohibits dumping in the ordinary accepted meaning of that word; that is, the sale of merchandise in the United States for less than its foreign market value or cost of production; but also bribery, espionage, misrepresentation of goods, full-line forcing, and other similar practices frequently more injurious to trade than price cutting."[47]

In Section 337, before the commission can act with respect to nonpatent, copyright, trademark, mask work, or design claims, it must investigate two issues: 1) whether "[u]nfair methods of competition and unfair acts in the importations of articles … into the United States, or in the sale of such articles" exist; and 2) whether such unfair methods and acts represent a threat or have an effect of "destroy[ing] or substantially injur[ing] an industry in the United States."[48] For patent, copyright, trademark, mask work, and design claims, the commission must investigate whether the affected industry in the United States "exists or is in the process of being established," but does not have to investigate whether the affected domestic industry has been injured.[49]

As one article notes, "The Court of Customs and Patent Appeals has suggested that the Commission may have 'wide discretion in determining what practices are to be regarded as unfair' since '[t]he importation of articles may invoke questions which differ materially from any arising in purely domestic competition.'"[50] The act also provides the commission with a range of actions in cases of unfair methods of competition or unfair acts involved in the importation of articles or their sale.[51] Most importantly, it can impose an import ban for a significant length of time. For example, when a Section 337 exclusion order is based on trade secret theft, it can last for the period of time it would have taken the foreign manufacturer/exporter to independently develop the misappropriated trade secret.

Despite the flexibility and the powers it provides to the USITC, section 337 has not lived up to its promise, and if it is to be used effectively as a trade defense tool against Chinese mercantilism, Congress will need to modify it.

Congress has occasionally amended Section 337 to respond to challenges. The 1935 case of Amtorg Trading Corp., the trading corporation of the Soviet Union that served as a cover for a system of industrial espionage targeted at U.S. commercial and technological secrets, spurred one such change.[52] The Soviet company had violated process patents (patents covering how to make something) of a U.S. firm, and that firm brought a complaint. However, USITC ruled that "[t]he Russian exporter had a perfect right to sell and the American importer had a perfect right to buy the [product] and to resell it in the United States, in so far as any question of a process patent is concerned."[53] In 1940, Congress enacted section 337a "establishing definitively that importation of an article manufactured abroad by a process that infringed a U.S. process patent was an unfair act within the law. Three decades later, in the Trade Act of 1974, the Congress expanded the authority of Section 377 so that the Commission 'has the authority to go well beyond patents.'"[54]

Despite this flexibility and the powers it provides to USITC, section 337 has not lived up to its promise. If it is to be used effectively as a trade defense tool against Chinese mercantilism, Congress will need to modify it.

SECTION 337 CAN PROVIDE A SOLUTION, BUT THERE ARE SHORTCOMINGS IN ITS CURRENT OPERATION

There are a number of limitations with Section 337 as currently written, interpreted, and enforced if it is to effectively be employed as a tool against foreign unfair trade practices.

Section 337 Mostly Addresses Patent Cases, Many of Which Are Filed Against US Firms

As noted, the legislative history of Section 337 is clear: Congress enacted it to protect U.S. firms from unfair competition from companies outside the United States where there was no other domestic judicial remedy other than an exclusion order. However, as R Street's Charles Duan wrote in 2021:

> The [USITC] is intended as a forum to protect U.S. industries from foreign importers unreachable through district court litigation, it ought to be dominated by investigations involving domestic complainants and foreign respondents. That is rarely the case. Among the 635 investigations in the full [USITC] dataset, 41 (6.5 percent) involved solely domestic complainants and foreign respondents … most [USITC] investigations involve at least one domestic respondent that could have been sued for infringement in a U.S. court.[55]

In recent years, the provision has been used extensively by U.S. and foreign multinationals to bring cases against each other for alleged IP violations.[56] While such actions can be important in ensuring property patent rights (although plaintiffs could also avail themselves of the federal courts), they do little to address unfair foreign trade practices. Between 2006 and 2020, the number of active USITC investigations increased by more than 70 percent, from 70 active investigations in 2006 to 120 in 2020, with most being patent cases.[57] Indeed, as Linda Sun wrote, "Some scholars argue that the [USITC] has departed from its original mission of protecting domestic industry and has become a patent validity court instead."[58]

This is in large part because "the [USITC] has procedural and substantive advantages that cement it as an important part of the patent law landscape."[59] That is surely the case, but the result is its utility as a trade defense measure has been considerably weakened.

For example, AliveCor, an American company focusing on remote heart monitoring solutions, brought suit against Apple for alleged IP violations in its smart watches.[60] Regardless of the merits of the case, it has nothing to do with foreign unfair trade practices and, as both companies have nexus in the United States, a U.S. court decision could address the issue.

To be sure, there are good reasons why plaintiffs want to use 337 rather than rely on the courts, including the fact that a Section 337 investigation has a shorter trial period than going through Federal District Court.

Finding of Harm Is Too High a Hurdle

For many years, the barrier to bringing a non-IP case (what is known colloquially as an "(a)(1)(A)" case) was quite high and required a very high injury standard. In other words, the petitioning firm had to show significant economic harm from the foreign firm's action. The commission did somewhat lower this barrier in the late 1960s, and the 1988 Omnibus Trade and Competitiveness Act eliminated the injury test for 337 cases involving certain IP (such as patents). But for other complaints, it still remains high. Former commissioner Minchew wrote that "under the Trade Act of 1974 it is only necessary to show that increased imports are a 'substantial cause' of serious injury to domestic industry."[61]

We can see this in the recent 337 case brought by Illinois Tool Works. The company "alleged misappropriation of trade secrets [by two Chinese companies] related to commercial foodservice equipment, as well as tortious interference with contractual relationships."[62] However, USITC ruled against the company because the complainants "had failed to show substantial injury to a domestic industry."[63] This was true because Illinois Tool Works was also importing its product from China. But a loss of sales to its Chinese competitors that stole its IP would ultimately hurt its U.S. operations, including sales, R&D, and management functions.

There is another key reason why there should be a revised hurdle of harm to focus on potential, including future, harm. The competitive position of a firm in an innovation industry can be harmed long before the actual harm is noticed. This can happen when a competitor, supported by unfair innovation mercantilism, gains market share and in so doing is able to lower its average costs because of scale economies. This lets the challenger invest more in production and innovation, leading to even more advantage. Soon there is a tipping point where the unfair competitor dominates (think of Huawei) and the incumbent either goes out of business (think of the telecom equipment firm Nortel) or shrinks. There could very well be cases wherein the domestic market is growing and the foreign firm benefiting from unfair trade practices gains only the new market growth. In this case, the U.S. firm would not be harmed in the short run (its sales would remain level), but its future growth and jobs would be harmed. Likewise, there may be cases in which a foreign firm gains market share in the United States in a way that limits a potential U.S. start-up firm from entering the market.

Antidumping Cases Cannot Also Qualify as Section 337 Cases

USITC has made it clear that if a case is "within the purview" of Department of Commerce jurisdiction over dumping and countervailing duties (CVDs) that the firm cannot qualify for action under Section 337.[64] The problem with this is the offending foreign firm may benefit from multiple unfair trade practices that should be able to be addressed by 337. While, in theory, these cases could be brought under Section 337, in practice, they have not been. Moreover, the remedy of CVDs addresses a particular violation at a point in time, although doing so does not address the fact that a firm can gain through unfair government actions long-term competitive advantage.

To be clear, countervailing duty law has been a very important trade law that has helped many U.S. industries and workers deal with foreign subsidies. But there is room for other, broader trade remedies in the system. More specifically, changes in Section 337 would allow it to cover more unfair practices, including broad-based unfair innovation mercantilist policies, that are different from the narrow scope of subsidies covered by CVDs (which require that there be a financial contribution, the financial contribution is made by the government or a public body at the direction of the government, there is a measurable benefit to the recipient, and the subsidy is specific). In addition, CVD cases cannot cover practices such as IP theft, IP infringement, closed foreign markets, or threats of retribution from the government. The injury test in CVD cases is likely harder to meet than in 337 cases, particularly if Congress amends Section 337.

Moreover, CVD cases can only cover a narrowly defined "like product" such as carbon steel pipe greater than 10 feet in length and containing xxx ingredients. The revised Section 337 would cover much broader classes of products from any firm benefiting from unfair trade practices. CVD cases (and antidumping cases, which are usually filed together) have shown themselves at times to be subject to circumvention by slight changes in the product or by transshipment through third countries. In addition, an exclusion order is more iron clad than a CVD order, which is a tariff. Finally, the WTO jurisprudence on China's subsidies has worn away the effectiveness of the CVD law over time. The United States has changed its practice to comply with the WTO and still have an effective law, but these changes have made the law expensive and cumbersome to use.

The Statute Was Written to Address Unfair Practices by Foreign Firms, Not Foreign Governments

Almost all cases USITC has ruled on affirmatively have been where a company acted unfairly, such as a patent violation, predatory pricing, false advertising, and false designation of origin. Indeed, as one scholar noted, "In the past the Commission has likened its jurisdiction over unfair practices in import trade to that of the Federal Trade Commission over domestic unfair trade practices under Article 5 of the Federal Trade Commission Act."[65] In other words, the focus has been on companies acting unfairly, not on foreign governments providing unfair support to their companies.

This focus on firms made sense a century ago when government mercantilist policies were less well established. But now that U.S. companies are confronting "state capitalist" systems—especially China's, where the government is the principal and massive supporter of unfair competitive aid and conditions—a focus on firm practices is too narrow. For example, many Chinese firms benefit unfairly from a wide array of practices, including direct and indirect subsidies from multiple levels of government, coerced technology transfer from foreign governments, a largely captive domestic market in which to sell to, and others. As such, it makes little sense to focus on just one of the company's current products when all its products should be the focus.

The Requirement for Industry to File a Case Limits the Number of Cases

One of the largest failings of Section 337 is it requires firms to bring cases. This is usually a financially costly undertaking, in which the odds of success are anything but assured. As Jeff Nall has written, "Few law firms specialize in [USITC] litigation cases, and once named as a respondent, litigation costs may be well over one million dollars per respondent."[66] Others suggest that this number is on the low end, with some cases costing participants $10 to $25 million.

The current process is akin to the police witnessing a robbery but not doing anything unless the victim brings a complaint. The result is less enforcement and less-safe communities.

Again, this process is based on the view that the violator is a foreign company and the violated is a U.S. company. In reality, in the case of Chinese innovation mercantilism, while individual U.S. companies are hurt, so too is the U.S. economy as a whole. To frame this in economic terms, there are considerable negative externalities from Chinese innovation mercantilism that U.S.

business owners do not bear. Workers, communities, and the national economy bear them. Therefore, again according to economic theory, firms will underinvest in enforcement relative to what is economically rational for the United States as a whole. In short, the current process is akin to the police witnessing a robbery but not doing anything unless the victim brings a complaint. The result is less enforcement and less-safe communities.

Related to this is the fact that it is unlikely U.S. multinationals with business in China (sales or production) will bring cases. They are more likely to bring cases against other multinationals than they are against Chinese firms because they know full well that they will likely face significant retaliation by the Chinese government. This can take the form of a trumped-up violation of a particular law, market access restriction, denied regulatory permission, or some other punishment intended to send a clear message: Keep your head down and don't complain. The chief counsel of a major U.S. corporation complained to the relevant Chinese minister about rampant IP theft and said that his company would bring a WTO case if the Chinese government did not rectify the matter. The minister said that if the company did bring the case, they would not sell any more products in China in the future. Essentially, the minister made this company an "offer they could not refuse."[67]

Judicial Appeals Enable Chinese Firms to Win on Legal Technicalities

USITC decisions may be appealed to the U.S. Court of Appeals for the Federal Circuit. This reliance on the rule of law makes sense when dealing with cases that involve companies from nations where it exists and is practiced. The problem is many Chinese government innovation mercantilist practices are difficult to prove in a court of law because the actions are opaque and not on paper and therefore hard to prove in a court of law. But that does not make it any less harmful. As a result, Chinese firms have taken advantage of the U.S. legal system to win cases in which there is legal uncertainty but it's fairly clear that the Chinese firms have benefited from IP theft or unfair trade practices.

"Articles" Are Too Narrowly Defined

The Tariff Act of 1930 provides USITC with authority to remedy only those unfair acts that involve the importation of "articles." The Federal Circuit interpreted what it means to be an "article" under this language in *ClearCorrect Operating, L.L.C. v. Int'l Trade Comm'n*, 810 F.3d 1283, 1299 (Fed. Cir. 2015).[68] It found that electronic transmissions are not "articles," as they are not "material things." This means that as more of the economy becomes digital, the commission lacks jurisdiction over a larger share of imports.

Enforcement Is Inadequate

Unlike other trade remedy tools in which the result is often a tariff, USITC can issue exclusion orders that block imports. However, the remedy requires that the products actually be excluded from the U.S. market. In the past, this was sometimes difficult. As the Congressional Research Service noted in 2009 regarding Customs and Border Protection (CBP):

> Concerns also have been raised about CBP enforcement of exclusion orders. A recent Government Accountability Office (GAO) report notes that U.S. companies spend millions of dollars to file Section 337 complaints before the [USITC], but that enforcement of exclusion orders is limited because of a lack of resources. As of July 2007, CBP reported that 66 exclusion orders were in effect. The number

> of exclusion order exams carried out by CBP has declined since FY2002. While U.S. capacity to carry out I.P.R. enforcement has increased, according to GAO, challenges remain because IPR enforcement frequently may not be a top CBP priority and there may not be adequate resources targeted to this effort.[69]

Congress did increase funding, allowing CBP to establish an exclusion order office. However, going forward, it will be important for Congress to monitor CBP performance and, if necessary, provide increased resources.

OPERATIONALIZING A STRATEGY OF DENYING MARKET ACCESS TO FIRMS BENEFITING FROM UNFAIR TRADE PRACTICES IN NON-MARKET ECONOMIES

It is time for the U.S. government to add an assertive tool of trade self-defense against China. The focus should be on banning imports from Chinese firms (not multinational firms operating in China) where there is a reasonable assurance that the firms benefited from significantly unfair economic, technology, trade, or other practices that give them an unfair advantage in the U.S. market.

Defining Unfair Trade Policies in Non-Market, Non-Rule-of-Law Nations

Any reformed section 337 would need to adequately define "unfair." All nations engage in some kind of "unfair" practices that give some or all of their exporting firms an advantage beyond what the firms could achieve acting legally on their own. Some free traders will argue that since all nations are "sinners," allied nations have no right to hold out mercantilist nations such as China for special treatment. In reality, it is the Chinese government that holds itself out for special treatment because of the unprecedented scope and size of its unfair practices—and their difficulty in being adjudicated. The reality is China is unique in the history of the world in its embrace of unfair trade practices, as the Center for Strategic and International Studies recently found in its study of Chinese industrial subsidies.[70]

Regardless, there needs to be some standards by which episodic, run-of-the-mill unfair practices can be distinguished from more systemic and egregious practices. To free-trade purists, this is an exercise in futility: Something is either a distortion of free trade or it is not. But in the real world, extent and size matter.

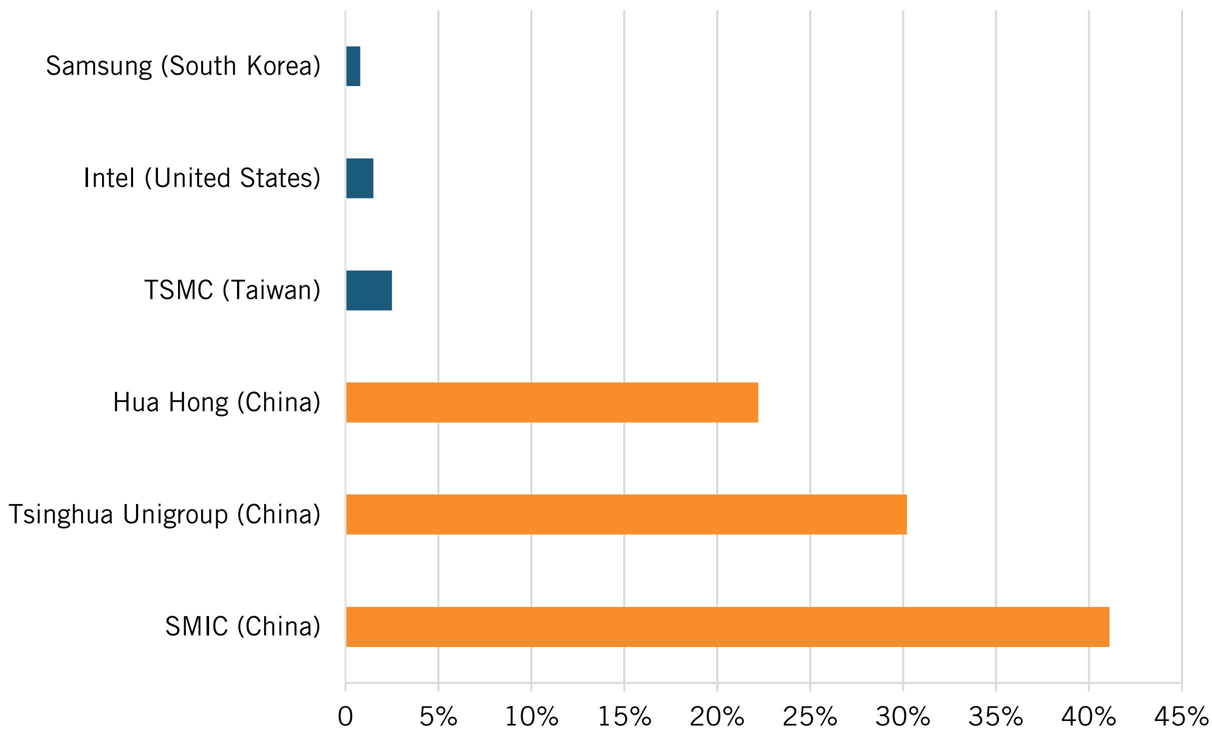
Some practices should generally be seen as per se unfair trade practices, including forced technology transfer (e.g., forced joint ventures) and IP theft. But there are others for which degree matters, such as subsidies and domestic market restrictions. The Organization for Economic Cooperation and Development (OECD) recognizes that it is important to draw a rough line to distinguish between legitimate industrial and technology policies and those that are systemically unfair. In its forum on export credits it attempts to do this, stating:

> The OECD is also a forum for maintaining, developing and monitoring the financial disciplines for export credits, which are contained within the Arrangement on Officially Supported Export Credits (the "Arrangement"). These disciplines stipulate the most generous financial terms and conditions that Members may offer when providing officially supported export credits.[71]

In other words, there is broad agreement among OECD nations that a reasonable level of export financing (financing terms and levels as a share of the export good) is acceptable, but that levels beyond that are unfair. As such, the Biden administration should work with OECD to establish a similar forum on all subsidies and domestic market restrictions. Moreover, the WTO Subsidies Agreement used to state that subsidies beyond 5 percent of sales were per se injurious (Article 6.1a.) This provision was not maintained in the WTO after five years, as it needed to be voted on again. If OECD cannot come to a consensus on this, the administration should go forward on its own, ideally with several key allies, to develop its own standards of what constitutes legitimate industrial support and what goes beyond that into the realm of innovation mercantilism.

Take the case of semiconductors. In large part because of China's massive state subsidies for semiconductors, a number of nations, including the United States, have put in place new incentive programs for domestic chip manufacturing. But to date, the subsidies provided by the Chinese government are more than an order of magnitude larger than what other governments provide. As such, it is reasonable to conclude that three Chinese semiconductor firms—SMIC, Tsinghua Unigroup, and Hua Hong—have benefited from unfair Chinese practices. In fact, from 2014 to 2018, state subsidies accounted for slightly over 40 percent of SMIC's revenues, 30 percent for Tsinghua Unigroup, and 22 percent for Hua Hong. (See figure 1.)

Figure 1: State subsidies as a percentage of revenue for chip fabs, 2014–2018[72]



Preferential market access should also be defined. Of course, no firm is likely to have the same market share in every country, but in China, many markets are allocated, not competed for. Take the case of telecommunications equipment. Outside China (and outside countries where Chinese equipment is banned for security reasons), the share of non-Chinese makers (such as Ericsson, Nokia, and Samsung) is much higher than it is in China where Chinese companies have virtually all of the market. This should be prima facia evidence of unfair market policies, unless the plaintiff can convincingly argue otherwise.

Moreover, such a new regime should only cover non-rule-of-law, non-market economies (particularly China's) where conventional trade disputes cannot be effectively adjudicated in other fora, including the WTO. The key here is to include both factors. Some economies could be non-market but have adequate rule-of-law procedures to allow unfair trade to be adequately addressed. It's when a nation such as China is neither a market economy nor has the rule of law that real difficulties arise.

Reforming Section 337

Given the existence and legislative history of Section 337, it is an ideal tool to be adapted for today's U.S. trade challenges. But to operationalize it in a way that is effective—and also not too broad—there are a number of reforms Congress, USITC, and the Biden administration should make.

Beef up 337's unfair trade provisions.

As noted, 337 has been increasingly used to adjudicate patent cases between multinational companies. While reforms to this process may be needed, they are beyond the scope of this paper.[73] Moreover, there is no reason to do away with this avenue of IP protection for firms doing business in America.

The goal should be to beef up the unfair trade practices component of the statute. However, USITC has noted, "Most Section 337 investigations involve allegations of patent or registered trademark infringement. Other forms of unfair competition, such as misappropriation of trade secrets, trade dress infringement, passing off, false advertising, and violations of the antitrust laws, may also be asserted."[74]

It does not talk about forced technology transfer, closed domestic markets, subsidies, or other unfair practices. In fact, as Kaye and Plaia Jr. wrote in the *Maryland Journal of International Law*, the commission, in its Memorandum Opinion in *Color TV Sets* stated that "section 337 is an authority of concurrent jurisdiction with all other statutes applicable to unfair practices in import trade … since in most cases bounties or grants are actions of a foreign government it would appear that such activities would not be the type of unfair methods of competition or unfair acts contemplated by section 337."[75]

The Commission could start by modifying this ruling and making it clear that going forward unfair trade practices would have a much wider scope to include virtually any action from a non-market, non-rule-of-law nation that gives a significant competitive advantage to its firms.

Ideally, Congress would make it clear that these and related unfair trade practices are eligible for Section 337 investigations, but only against companies from non-market, non-rule-of-law economies. The purpose of reforming Section 337 is not to be able to better adjudicate trade issues with our allies—we have bilateral trade agreements and the WTO for that.

In addition, exclusion orders should be able to be issued not against a particular product (e.g., 12-inch steel pipe), but rather on all products or services from a firm in a non-market, non-rule-of-law economy found to have benefited from unfair trade practices.

Eliminate the requirement for injury for unfair trade practices claims.

Over time, Congress has somewhat eased the injury standard for winning Section 337 decisions related to IP violations. However, for unfair trade practice investigations commenced under subsection of the statute, the standard remains too high. As USITC noted in unfair trade cases, "[T]hreatened or actual injury must be shown."[76]

It should be irrelevant if the domestic company is harmed in the here and now. The point is that the unfair practices should not be rewarded, period. The other point is that all too often, especially in technologically complex industries, by the time harm is determined it is too late: The company has suffered irreversible decline in its competitive position. Adjudicating blame becomes a coroner's inquest over dead U.S. companies, For instance, the $42 billion in subsidies for solar photovoltaic (PV) cells the Chinese government provided from 2010 to 2012 alone helped China's global share of production of PV cells (the industry's core technology) surge from 14 to 60 percent between 2006 and 2013.[77] The effect of this surge was to knock some 200 to 300 U.S. solar start-up companies out of business.[78] As such, Congress should eliminate the requirement for injury in unfair trade practice claims against non-market countries when the unfair trade actions are pervasive and large.

Make it clear that any agency of government can file a complaint to initiate a Section 337 unfair trade investigation against innovation mercantilists from non-market, non-rule-of-law economies.
Under current law, only companies can bring Section 337 complaints, and only the Commission can self-initiate an investigation. As noted, this limitation has led to significant underenforcement against non-market economy nations' unfair trade practices. Chinese practices that give its companies an unfair advantage in international markets harm the United States as a whole, not only firms in the United States. As such, any agency of the U.S. government should be able to file a Section 337 complaint to defend the nation against this kind of economic aggression.

Increase funding for the departments of Commerce and Justice to file Section 337 unfair trade practices cases with USITC and increase its funding to handle these cases.
To date, the U.S. government has not approached trade enforcement strategically in the context of an overall national industrial strategy. If it did, it would systematically investigate unfair trade practices in countries such as China that harm key U.S. industries.

Moreover, other federal agencies, including Commerce and USTR, have taken a hands-off approach to USITC, rather than using it as a tool for U.S. trade policy. The problem with that approach it is ITC does not have the resources to proactively investigate unfair trade practices in non-market economies and has less insight into those practices than Commerce or Justice departments have. Staff in USITC's Office of Unfair Import Investigations focus on investigating particular 337 cases filed by industry.

The U.S. government needs greater resources and commitment to assessing unfair trade practices in China. USTR has some of these resources, but its role is principally in trade negotiation. As such, Congress should establish within the Department of Commerce's International Trade Administration the position of Assistant Secretary for Non-market Economy Analysis whose mission would be to thoroughly analyze and document the extent of unfair trade practices in economies such as China's (particularly at the industry and firm level), and where warranted, work with the Department of Justice to file Section 337 complaints at USITC. To do that, Commerce should hire staff fully proficient in Mandarin, with some based in China.

One advantage of this is it would send a clear signal to USITC and its commissioners that some key cases are important to the national interest, and it would mean that more information about unfair trade practices is officially on the record.

Congress should increase funding for USITC to enable it to handle its increased responsibilities in enforcing Section 337. USITC is already underfunded given its current mission and scope. If Congress reforms and expands the scope of Section 337, it will need even more resources to address the challenge. Such funding should be considered an investment. Just as funding the Department of Defense is an investment in U.S. military security, funding USITC is an investment in U.S. economic security.

Congress should establish within the Commerce Department's International Trade Administration the position of Assistant Secretary for Non-market Economy Analysis.

One reason there have not been more unfair trade cases before USITC is the commission has been conservative in its interpretation of what "unfair" means. It does not want new theories or interpretations of unfair trade practices because it rightly knows that it has limited resources and could be overwhelmed with cases. Congress should rectify this by increasing funding for both the Office of Unfair Import Investigation and the Office of the Administrative Law Judges.

Amend Section 337 to allow broader exclusionary orders to classes of products, including digital products.

It makes no sense to have a different standard for unfairness or IP violations to tangible products than for intangible (often digital) products. Congress should clarify the law to that end.

Make the use of Section 337 for IP cases between U.S. and allied multinational firms more difficult.

As noted, the lion's share of 337 cases involve patent and other IP disputes, often between two American companies. Congress should take steps to reduce the attractiveness of using 337 for these kinds of cases firms can bring in Federal District Court instead. One bipartisan bill, H.R. 5184, introduced by Congresswoman Susan DelBene (D-WA) and cosponsored by Representatives Schweiker (R-AZ), Estes (R-KS), and Beyer (D-VA) would make needed changes, including to the domestic industry standard to require actual adoption and use of the disputed articles, to require licenses to willingly join the claim if they are listed by the claimant, and to require the initial determination of the administrative law judge for an exclusionary order to take into account the public interest standard. Another change could require that exclusion orders could not be made unless the product in question by the plaintiff is commercially offered. Congress could also extend the time USITC has to make its decisions on IP cases.

Reduce the legal standard for winning cases against firms in non-market, non-rule-of-law economies that benefit from unfair trade practices.

One of the challenges with winning Section 337 cases against Chinese firms is the latter are becoming much more sophisticated in defending themselves, often hiring premier Washington DC law firms to defend them. In fact, China's Ministry of Commerce has prequalified certain U.S. law firms Chinese companies may enlist when Section 337 cases are brought against them.[79] The Chinese government also provides counsel and help to its firms to avoid being found to have violated Section 337.[80] And while all firms in theory are entitled to full judicial access in the United States, giving firms in non-market, non-rule-of-law nations the same rights as firms in other nations means "guilty" firms in the former are more likely to win than they would otherwise. The reason is the non-rule-of-law nature of the Chinese system means it can be hard to meet a high evidentiary standard that would be appropriate in a rule-of-law nation. As such, Congress should mandate that lower standards of evidence apply to cases involving non-market, non-rule of law economies.

One way to do this is to apply a "rebuttable presumption," something the Uyghur Forced Labor Prevention Act (UFLPA) contains. China's lack of transparency makes it more difficult for U.S. Customs to determine which imports from China were produced with forced labor. The UFLPA requires the U.S. government to shift the burden of proof to companies with supply chains that involve products from Xinjiang Uygur Autonomous Region, to show that they were not using forced labor to manufacture the products imported into United States.

"Rebuttable presumption" should also be applied to unfair trade practices from non-market, non-rule-of-law countries. This would not ban imports per say, but would shift some of the burden of proof to the Chinese firm that is facing a 337 exclusion order.

In such instances, if U.S. companies or U.S. agencies bringing cases can show with a reasonable level of assurance that Chinese companies are unfairly benefiting from unfair trade policies and practices, and the relevant Chinese companies cannot definitively disprove the claims of unfair benefit, an USITC exclusion order would not be able to be overturned by the courts.

Congress should also allow these kinds of unfair trade practices cases against non-market economies to be decided over a longer period than the current 15-month requirement. The reason is these cases can be more complicated to investigate and adjudicate, and it is important that USITC has adequate time to do so.

The president should appoint USITC commissioners who are committed to supporting 337 unfair trade practices and see all forms of innovation mercantilism as an unfair trade practice.

If USITC is to enforce exclusion orders against Chinese firms' products (goods or services) that are based significantly on unfair trade practices, it needs a significant majority of commissioners who support this revised role.

Narrow public interests standards.

Before issuing an exclusion order, the commission must consider the effects of such orders on four public interest factors: 1) public health and welfare; 2) competitive conditions in the U.S. economy; 3) production of like or competitive articles in the United States; and 4) U.S. consumers.

To be sure, these public interest factors have only been invoked a few times, but even so, numbers 2 and 3 could be problematic.[81] There is no reason not to block non-market economy products given an unfair advantage by the firm's government just because it might boost U.S. domestic economic competition. If there is an issue with U.S. domestic market power, government should address it through antitrust action, not by turning a blind eye to unfair imports. The same is true with production of "like or competitive articles" in the United States. Unless there is a public health and welfare issue or pressing consumer issue, it shouldn't make any difference whether there is U.S. production. Market forces exist that would mean a firm would respond to an exclusion order and begin to produce in the United States or an allied nation.

Amend Section 337 to allow cases to go forward in USITC even if they are eligible under dumping or countervailing duty cases in the Department of Commerce.

As Kaye and Plaia noted,

> Section 337 (b) (3) provides: Whenever in the course of an investigation under this section, the Commission has reason to believe, based on information before it, that the matter may come within the purview of section 303 or of the Antidumping Act, 1921, it shall promptly notify the Secretary of the Treasury so that such action may be taken as is otherwise authorized by such section and such Act. And the legislative history explains: It is expected that the Commission's practice of not investigating matters clearly within the purview of either section 303 or the Antidumping Act will continue.[82]

This has been interpreted to mean that these cases cannot be prosecuted as 337 cases. In fact, USITC often refuses to take cases involving CVDs because the firms are supposed to avail themselves of Department of Commerce procedures. This may make sense when dealing with complaints related to market economies, but it does not make sense in dealing with non-market economies such as China's in which the unfair trade practices are as egregious and systematic as they are, as it can often be difficult to win these cases. Firms should not have these cases dismissed simply because they involve CVDs. USITC should rule that both kinds of cases can be brought as 337 cases. And in renewing the statute, Congress should make this clear as well.

Provide a tax credit to companies for the costs of bringing Section 337 unfair trade practices cases against non-market, non-rule-of-law economies.

The benefits of successfully pushing back against unfair Chinese trade practices are much larger than those a particular firm obtains from winning a case. As such, from a societal perspective, firms will bring fewer cases than is economically optimal. Congress should provide a generous tax credit—perhaps on the order of 50 percent—for legal costs for bringing Section 337 unfair trade practices against firms in these economies, with the firm being eligible for the credit only if USITC rules in its favor.

Increase CBP funding to implement exclusion orders on unfair trade cases affecting non-market economies.

Section 337 remedies are worth little without effective enforcement. It would be akin to a judge prosecuting a repeat burglar, only to have the criminal let out of jail due to a lack of jail cells. U.S. CBP needs adequate resources to ensure that virtually all the products that are attempted to be imported in violation of a 337 ruling are in fact interdicted and denied entry.

Working With Allies

If there is an Achilles heel to this proposal it is that U.S. firms could be on the receiving end of Chinese government retaliation, even if it is the U.S. government that initiates Section 377 unfair trade cases. Indeed, the Chinese government openly admits that it favors such retaliation as a weapon to keep cases from being brought.[83] In these instances, U.S. firms are likely to pressure the administration to not bring cases, in part because such retaliation is likely to mean reciprocal economic harm imposed on U.S. firms and resultant damage to U.S. workers.

As such, any 337 reform initiative focused on unfair trade needs to be complemented with a strong push by the administration to create a multinational Section 337 regime, just as allied nations have done with certain export control issues, as exemplified with the Wassenaar Agreement, a voluntary regime of 42 members that limits arms exports to threatening nations. A similar agreement should be established among allied, rule-of-law, market-based nations to agree to joint import bans of products from non-market firms found to be benefiting significantly from unfair trade practices.

There is a second reason why it is critical the United States and its allies cooperate: As large as the U.S. market is, cutting off access to it alone will not be enough to limit the global rise of Chinese firms, as they could just try to flood other nations' markets, thereby hurting both domestic firms in those markets and allied nation firms that export to it. For that to happen, more of the world's economy needs to be closed to Chinese firms that benefit inappropriately from unfair trade practices.

As the administration works to coordinate such market exclusion programs with allies, it should also establish a formal innovation mercantilism intelligence sharing process whereby allied nations share information on various and sundry unfair practices benefiting a specific list of major Chinese firms.

Other Nations' Efforts

Establishing such a joint effort is made easier by the fact that some allies are taking similar steps. For example, Japan's new economic security law and its formation of an economic security minister position, while not directly including a Section 337-like initiative, could set the stage for Japan adding such an initiative.[84]

As the administration works to coordinate such market exclusion programs with allies, it should also establish a formal innovation mercantilism intelligence sharing process whereby allied nations share information on various and sundry unfair practices benefiting a specific list of major Chinese firms.

The EU has (belatedly) taken steps to address unfair foreign subsidies. The logic of its subsidy regime is as follows:

> The main cause of the problem is the existence of distortive foreign subsidies based on the industrial strategies of certain non-EU countries and the absence of any regulatory mechanism to prevent or remedy their distortive effects. While the granting of support by Member State authorities is subject to EU State aid control, there is no control of the impact of foreign subsidies on the internal market, thereby putting the EU industry at a disadvantage when competing with undertakings that receive foreign subsidies.[85]

The EU subsidies regime, while an important step forward, suffers from a number of conceptual and practical challenges. First, it focuses on subsidies that "distort the market." As the law defines problematic subsidies, "A distortion on the internal market shall be deemed to exist where a foreign subsidy is liable to improve the competitive position of the undertaking concerned in the internal market and where, in doing so, it actually or potentially negatively affects competition on the internal market."[86]

In reality, markets often should be distorted, as in the case, for example, of promoting clean energy. The issue is not distortion; it is predatory unfair trade practices that seek to gain market share globally in a way that violates agreed upon norms and rules.

Second, it is too narrowly focused on subsidies, and not on other unfair trade practices—especially those related to IP and tech transfer—and domestic market protection. Third, remedies are limited to shutting firms that violate the rules out of public procurement and limiting mergers—measures that don't go far enough in reducing the benefits of these unfair foreign practices. Fourth, it is too broad in geographic scope, potentially covering government aid in allied, market-based nations, including the United States.

Finally, it is too broad in subsidy scope. The proposed regulation notes a "a foreign subsidy shall be deemed to exist where a third country provides a financial contribution which confers a benefit to an undertaking engaging in an economic activity in the internal market and which is limited, in law or in fact, to an individual undertaking or industry or to several undertakings or industries."[87] Given that many U.S. companies receive location incentives from state and local governments, albeit usually modest, this regulation would enable the EU to ban most U.S. companies from public procurement or acquisitions, even though virtually every major EU firm has been subsidized in any way, shape, or form. The EU should limit the whole idea of this remedy to non-market economies, as defined here.

Nonetheless, if the program were narrowed to focus only on non-market economies, expanded to include more types of unfair trade practices, and included market exclusion remedies, the program could effectively complement a similar U.S. program.

Should the U.S. government develop a program and at least some allies adopt a similar one, all parties could work together to exchange information on unfair trade practices and the foreign firms benefitting from them. Collectively, such a cooperative trade defense tool would go a long way to ensuring that "trade crime does not pay."

RESPONDING TO POSSIBLE CONCERNS

In response to this proposal, some will likely raise a number of concerns or criticisms.

This Is Protectionist

For some free traders, any action that limits trade is protectionist. To be sure, imposing trade restrictions on foreign firms that are largely playing by the rules in order to protect domestic industry is protectionism. But imposing trade restrictions on foreign firms that are competing unfairly is no more protectionism than is the Federal Trade Commission prosecuting domestic firms for unfair and deceptive business practices is domestic protectionism on behalf of their competitors. As Thomas Jefferson wrote, "Where a nation imposed high duties on our productions, or prohibits them altogether, it may be proper for us to do the same by theirs."[88] It's time for a less binary view of trade in Washington, understanding that fighting foreign mercantilism, even with trade remedies, is not protectionism. It is the opposite: an attempt to restore global free trade.

One way to address this concern and gain the support of free traders would be to tie this new trade defense measure to a grand bargain: The United States would limit imports from non-rule-of-law, non-market economies that have significantly benefited from unfair trade practices, while at the same time once again supporting liberalized trade with democratic nations. This should start with the Biden administration joining the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, the successor to the TPP, crafting a trade agreement with the United Kingdom, and moving forward on the next version of the Information Technology Agreement.

While hopefully even the most hard-core free trader will agree with the distinction between protectionism and defense, one valid concern they still might have is that the tool will be used by government (or firms) in a protectionist, rather than a trade defense, way. To limit this risk, Congress should take care in reforming the statute to ensure that only cases that involve high levels of unfair trade practices (ideally assessed against an OECD-derived set of standards) in non-rule-of-law, non-market economies are covered.

The United States Engages in Industrial Policy Too

With the recent passage of the CHIPS and Science Act—legislation that, among other things, appropriated tens of billions of dollars to support a strong U.S. semiconductor industry—some will argue that the United States is in no position to complain about Chinese innovation mercantilist policies. This is wrong. There are two big differences between what the United States has done and what China has done. First, as noted, government support for industry in the United States is an order of magnitude smaller than it is in China, as a recent Center for Strategic and International Studies (CSIS) report shows. Second, most Chinese unfair policies are reserved for Chinese-owned firms. Virtually all U.S. policies, such as the CHIPS Act, the Manufacturing USA centers, and the R&D tax credit, are available to firms operating in the United States, largely regardless of their nationality.

This Approach Would Cost Money

For this new trade defense tool to work effectively, relevant agencies—Commerce, Justice, USITC, and CBP—will need increases in their budgets. But rather than look at these increased appropriations as spending, they should be looked at as investments in U.S. economic (and ultimately military) security. The federal government spends over $800 billion a year on national defense and intelligence, yet the amount spent on economic and trade defense is easily only 1 percent of that amount. Banning imports of Chinese goods from companies that benefit illegitimately from Chinese government support would not only slow down China's efforts at civil-military fusion, but also help protect the U.S. defense industrial base.

This Approach Could Overshoot or Undershoot the Mark

Some may argue that, given the extent and opacity of Chinese unfair trade practices, a new Section 337 regime will fail to capture all the cases, including of firms that benefit little from Chinese government unfair trade practices. The former is true, but it misses the point. As it stands now, very few cases are captured, and other trade tools, such as Section 301, are not adequate to address all the Chinese challenges.

In contrast, some may argue that this regime risks bringing in Chinese firms that do not significantly benefit from unfair trade practices. The analytical process, both at the U.S. Department of Commerce to more thoroughly and accurately identify unfair trade practices and the judicial procedure at USITC, would limit "false positives" to a minimum. But even if a few firms are swept up that perhaps should not be, there is an easy answer for the Chinese government: roll back its innovation mercantilist practices, and when it is clear that China is in compliance with general OECD guidelines on unfair trade, the United States and other nations can sunset this regime.

This Strategy Violates WTO Rules

There is a general consensus, even in Geneva, that the WTO is poorly set up to address abuses from non-market economies—especially China's. As noted, there are several reasons for this, including Chinese threats against foreign firms that bring cases and the opacity and vagueness of China's unfair trade practices that make enforcement in a legal body such as the WTO difficult.

Because of this, more and more allied nations are realizing that they must take unilateral action to address the challenge. Even the EU recognized this when it put in place its new foreign subsidiary law. Moreover, as long as a revised Section 337 statute is focused on non-rule-of-law, non-market economies, there is less risk of a WTO challenge.

This Strategy Will Bring Retaliatory Action

Perhaps the most astute criticism of this proposal is that it would lead China to retaliate against U.S. firms, in turn hurting U.S. workers and the U.S. national interest. The fact that most people know that this is a real risk should give pause to anyone who thinks that the Chinese government plays by the rules. While retaliation is a risk, it should be noted that China's policies are inflicting tremendous damage on U.S. and allied firms already.

The most effective way to address this issue is to work with allies to encourage and help them implement a similar program. Clearly, such a shared program would be in the interest of all allies that face Chinese economic predation against firms in their nation. Whether enough of a critical mass can be assembled remains to be seen. But we won't know until we try.

It's time to make Chinese unfair trade practices less profitable by sending a clear message to China: If you significantly violate global rules and norms for an industry in China, the firms in that industry will not have access to U.S. and allied markets.

CONCLUSION

The Chinese government has made it clear that it seeks global competitive leadership in a vast array of advanced industries. These markets are zero-sum: If China gains market share, other nations either lose or do not grow output. Continued loss of U.S. (and allied) global market share in advanced industries would be transformational—weakening the "West" while making China the unalloyed economic power on the planet.

Absent a significant change in Chinese government leadership, Chinese policies cannot be changed. And while efforts to get the United States to "run faster" could help, it's not likely America will respond as needed—and even if it did, it would not be enough to address Chinese unfair and predatory trade practices.

It's time to make Chinese unfair trade practices less profitable by sending a clear message to China: If you significantly violate global rules and norms for an industry in China, the firms in that industry will not have access to U.S. and allied markets. Doing that would not only send a clear message of support for free trade, but also slow down Chinese firms while enabling allied nation firms to more effectively compete with their Chinese government-backed state champions.

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ENDNOTES

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80. The Chinese are aware of this. One Chinese article advising firms and the government stated that "when the risk of infringement is high, companies need to design around to make new products not fall into the protection scope of patent claims and pass ITC certification thereby letting new products can enter the US market." The authors also stated, "For listed corporations, Section 337 Investigations may result a drop in share price. Therefore, in order to reduce such losses, respondent will choose to settle with applicants as soon as possible." Furthermore, "considering the large scale of the company, in order to avoid problems such as stock price decline and loss of customers due to the Section 337 Investigation, companies should tie up with local news media and guide them to positively publicize their actively response to the lawsuit thereby taking advantage of the marketing value of the Section 337 Investigation."; Zhu Xuezhong and Xu Chenqian, "The game analysis of enterprise patent litigation strategies under Section 337 Investigation," *Science Research Management*, vol. 42, issue 6 (2021): 112–119, http://journal26.magtechjournal.com/Jwk3_kygl/EN/abstract/abstract22452.shtml.
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83. Zhu Xuezhong and Xu Chenqian noted that Chinese "[e]nterprises can take counter-measures in China, such as invalidating Chinese family patents, filing counterclaims in domestic courts, and accusing the applicant of abusing market dominance. These legal measures are less costly and will help companies reach a private settlement without letting competitors get a free ride." They instruct, "First, seek the policy support and guidance of the government. Second, ask industry associations to contact other respondents for establishing a response alliance which can share litigation expenses and relatively increase the economic burden of the applicant thereby increasing the probability of applicant withdrawing the case. Lastly, when the risk of infringement is high, companies need to design around to make new products not fall into the protection scope of patent claims and pass ITC certification thereby letting new products can enter the US market."; Zhu Xuezhong and Xu Chenqian, "The game analysis."
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