

Main Contents and Problems of the U.S. “Chip Act” and China’s Response in the Context of WTO

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Abstract: With the rise of unilateral protectionism and the blockage of World Trade Organization (WTO) multilateral trading system reform, the United States (U.S.) provides huge financial support to its semiconductor industry through the “Chip Act.” Besides, the U.S. attempts to improve the competitiveness of its semiconductor industry and dominate the international semiconductor market by setting up a series of “guardrails provisions” to curb the development of “foreign countries of concern,” such as China. Through documentary analysis, the main contents of the “Chip Act” are clarified, and its justiciability and compliance are analyzed from the perspective of WTO rules. In terms of actionability, the “Chip Act” meets the general conditions of subsidies and possesses the traits of specificity but at the same time causes damage to other countries’ industries, thus constituting an actionable subsidy. In terms of compliance, the discriminatory provisions of the “Chip Act” violate the principle of non-discrimination. Accordingly, China should actively respond under the WTO framework by promoting the resolution of the Appellate Body crisis and the reform of the dispute settlement mechanism as well as participating in subsidy reform negotiations and contributing Chinese solutions; China should also take the initiative to apply countervailing rules to the “Chip Act” while improving its own trade remedy system.

Keywords: WTO; Chip Act; Principle of non-discrimination; China

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1. Introduction

Against the backdrop of the World Trade Organization (WTO) Appellate Body shutdown and the urgent need for a reform of the dispute settlement mechanism, President Biden, on August 9, 2022, signed into force the CHIPS and Science Act of 2022 (“Chip Act”), which seeks to bypass the WTO multilateral oversight mechanism and boost the United States (U.S.) semiconductor industry through a number of discriminatory measures. In order to curb China’s rapid rise in the semiconductor field, the Act has made numerous prohibitive or restrictive provisions specifically for China, which has and will affect Chinese companies to varying degrees in terms of purchasing key technology equipment, participating in U.S. manufacturing programs, obtaining U.S. funding, and bringing in international talents. Therefore, the study of the U.S. “Chip Act” from the perspective of WTO, which points out its justiciability and compliance issues under the WTO system and provides suggestions for China’s response to the Act, on the one hand, can promote the Chinese government and enterprises to actively carry out risk analysis and formulate response strategies as well as actively defend their legitimate rights and interests by using legal weapons in the multilateral trade framework; on the other hand, it can promote the WTO to reform the dispute settlement mechanism and counter the adverse effects of economic reverse globalization caused by the “Chip Act,” so that the multilateral trading system can be developed in a sustainable manner.

By analyzing the U.S. “Chip Act” through literature analysis and referring to relevant works and articles written by scholars, the main contents of the “Chip Act” and its effects can be clarified. Based on the legal analysis of the “Chip Act,” it has been found that the Act meets the constitutive elements of actionable subsidies and violates the non-discrimination principle of WTO. Ultimately, the measures to be taken by China are proposed.

2. Main contents of the United States “Chip Act”

The “Chip Act,” in terms of its overall structure, can be divided into three major parts. The first part is the “Chip Act of 2022,” which mainly provides financial grants for innovative activities in semiconductor manufacturing and open wireless access networks as well as tax credits for advanced semiconductor manufacturing but prohibits recipients of financial support from expanding chip manufacturing in “foreign countries of concern,” such as China. The second part is the “Research and Development, Competition, and Innovation Act,” which is a complex bill that allocates \$169.9 billion for research and development (R&D) in specific areas and establishes corresponding mechanisms. The third part is the “Supplemental Appropriations to Address Threats to the U.S. Supreme Court Act,” which allocates funds to the U.S. Department of Justice and the Supreme Court ^[1]. Of great concern to China is the inclusion of several discriminatory provisions against “foreign countries of concern” (hereinafter referred to as “guardrails provisions”).

The “guardrail provisions” are found in the first two major sections of the “Chip Act.” The “guardrail provisions” include the following: (1) companies that receive financial grants and investment tax credits shall be prohibited from expanding advanced semiconductor capacity in “foreign countries of concern”; (2) there shall be strict scrutiny of entities in “foreign countries of concern” like China before being allowed to join the U.S. manufacturing program, and unless exempted, Chinese companies are not allowed to join the “Made in America” program; (3) except as specifically provided or exempted, any funds appropriated to the National Science Foundation (NSF) shall not be appointed to institutions of higher education that enter into contracts or cooperative agreements with the Confucius Institute; (4) institutions of higher education receiving NSF financial support shall immediately disclose the information if they receive financial support of more than \$50,000, directly or indirectly, from a “foreign country of concern”; (5) federal research agency personnel are prohibited from participating in foreign talent acquisition programs, and individuals receiving federal research agency R&D grants are prohibited from participating in programs sponsored by “foreign countries of concern” or “foreign institutions of concern” and entities established in those countries ^[2].

3. Problems of the United States “Chip Act” from the World Trade Organization perspective

Comparing to the purpose stated in the introduction and the content of the text, it can be seen that the U.S. “Chip Act” completely deviates from the purpose of trade and investment liberalization as pursued by the international community; rather, it is a “draconian law,” full of trade and investment protectionist colors. Focusing on the WTO framework, the content of the bill fulfills the Subsidies and Countervailing Measures (SCM) Agreement on the requirements of actionable subsidies and seriously violates the WTO non-discrimination principle, namely the most-favored-nation treatment and national treatment principle.

3.1. Justiciability: The “Chip Act” constitutes an actionable subsidy

Under the WTO framework, according to the provisions of Articles 1, 2, and 5 of the SCM Agreement, for a measure to constitute an actionable subsidy, the following three conditions must be met: (1) the measure constitutes a “subsidy” under the SCM Agreement; (2) the key idea of the subsidy is specificity; and (3) the targeted subsidy causes adverse effects to the industrial interests of another country ^[3]. Among them,

there are three sub-conditions that need to be satisfied in order to constitute a “subsidy,” namely the subjective element, the formal element, and the effect element.

Through the analysis of the aforementioned constituent elements, the U.S. “Chip Act” constitutes an actionable subsidy. First, the funds provided by the U.S. through the “Chip Act” are directly granted by the U.S. federal government to relevant enterprises through financial subsidies and tax credits, so that the U.S. semiconductor enterprises obtain additional benefits that cannot be obtained in the market. Therefore, the measure provided by the U.S. government meets the conditions of the subject, form, and effect, which constitute subsidies under the SCM Agreement. Second, the financial support of the U.S. “Chip Act” is explicitly limited to the U.S. semiconductor industry, and there are no objective criteria or conditions for obtaining subsidies, which are industry-specific subsidies with legal exclusivity. Lastly, the measure “injures” the development of another member country’s semiconductor industry and adversely affects other countries’ semiconductor industry, thus constituting an actionable subsidy, whereby the injured country may resort to the multilateral dispute settlement mechanism or assume unilateral countermeasures, including countervailing duties and countermeasures.

3.2. Compliance: The “Chip Act” violates the World Trade Organization non-discrimination principle

In addition to constituting an actionable subsidy under the SCM Agreement, the U.S. “Chip Act” also violates the most fundamental legal principle of the WTO – the non-discriminatory treatment principle.

The most-favored-nation treatment principle and the national treatment principle together constitute the WTO non-discriminatory treatment principle, which is regarded as the cornerstone of the WTO multilateral trading system^[4]. The most-favored-nation treatment principle requires that the treatment given by WTO members to one member should be unconditionally given to other members, while the national treatment principle requires that the treatment given by WTO members to enterprises and products of other members should not be lower than the treatment given by them to domestic enterprises and products.

In contrast, the U.S. “Chip Act” raises discriminatory and obvious restrictive provisions, such as prohibiting enterprises from receiving subsidies that would increase the production capacity of advanced process chips in China and other “foreign countries of concern” for a period of 10 years and enforcing companies that violate the ban or fail to rectify the situation to return the full amount of subsidies and bear significant legal liability. The above provision reflects a serious discrimination against “foreign countries of concern,” such as China, which is a clear violation of the most-favored-nation treatment and national treatment principle.

The purpose of trade and investment liberalization is the cornerstone of the international economic and trade rules system since World War II and is the fundamental guarantee of global economic prosperity and development. In recent years, the U.S. has introduced various bills that run completely counter to trade and investment liberalization for its own geopolitical interests, and the introduction of the “Chip Act” is a blatant and undisguised violation of WTO rules, disregarding the international law obligations that the U.S. itself should assume. This despicable act should be jointly condemned by the international community. China, as a member of the WTO, should take various active measures, granted by the WTO, to oppose this illegal behavior of the U.S. and resolutely defend the purpose of trade and investment liberalization as well as the legal dignity of WTO rules.

4. China’s proposals to deal with the threat of the United States “Chip Act” under the World Trade Organization framework

Against the background of the suspension of the WTO Appellate Body and the urgent need for the reform of the dispute settlement mechanism, the U.S. has taken the opportunity to evade the supervision and

constraints of the multilateral trading system and adopted unilateral trade protectionist measures in an attempt to maintain its dominant economic and trade position. The U.S. enacted and implemented the “Chip Act” to distort the international semiconductor market in an attempt to curb the development of China’s and other countries’ semiconductor industry as well as regain its dominant position in the semiconductor field. In order to safeguard the multilateral trading system and national interests, China must act swiftly in response to this and take active measures to confront the hegemonic practices of the U.S.

4.1. Resolving the crisis of the Appellate Body and promoting the reform of the dispute settlement mechanism

In December 2019, the dispute settlement mechanism came to a halt because there were no new judges on the Appellate Body to fill the vacant positions, bringing the operation of the WTO to a near standstill. Against this backdrop, if the U.S. “Chip Act” is to be internationally monitored and regulated, it is imperative to resolve the Appellate Body’s suspension crisis, restore the function of the dispute settlement mechanism, and promote the reform and development of the mechanism.

In the short term, China should thoroughly examine Article 25 arbitration and other relevant rules of the Dispute Settlement Understanding (DSU), draw on or replicate the well-functioning system and experience of the ordinary litigation procedures of WTO, as well as support and improve the operation and practice of the WTO appellate arbitration mechanism. Specifically, these include the following three points: (1) China may attempt to enter into bilateral arbitration agreements with interested WTO members, thus agreeing to submit trade disputes to arbitration; (2) China should discuss with disputing parties the possibility of reaching agreements to initiate appellate arbitration on a case-by-case basis for cases involving China that are currently being heard by WTO panels; (3) China should take the initiative to play a constructive role, advocate and join WTO members with a common will to reach a consensus, lead the negotiation of the plurilateral Arbitration Agreement to gain more initiative, and speak up in the construction of systematic rules for the settlement of trade disputes by arbitration.

In the long run, the Appellate Body’s suspension should be addressed, and the DSU should be revised and improved to solve the mechanical problem fundamentally. Under the existing system, “member-driven” is an important feature of the WTO, which requires that rules under the WTO framework should be negotiated and agreed upon by member governments prior to adoption^[5]. As one of the mechanisms under the WTO framework, the appointment mechanism of Appellate Body members adheres to the principle of consensus adoption, *i.e.*, if one member opposes the appointment of another member of the Appellate Body, the appointment process will be stopped naturally. The existence of this principle has become the fatal flaw of the appointment mechanism, which is the direct cause of the present stalemate. Accordingly, China should propose to add relevant provisions to the DSU, especially to make clear provisions for member states to deny the appointment of justices and prevent the event of member states obstructing the normal operation of the dispute settlement mechanism without any reason. If a member state opposes the appointment or reappointment of an Appellate Body member, there should be reasonable grounds with sufficient evidence. For example, violation of DSU or other relevant rules by the incumbent, unfairness during the hearing of the case, violation of confidentiality obligations, *etc.*

4.2. Participating in subsidy reform negotiations and actively contributing Chinese solutions

The WTO subsidy rules are mainly led and formulated by the U.S. and other developed countries in the west. The subjects who formulate these rules will certainly design them based on their own interests, which will lead to the biasness and skewness of the existing WTO subsidy rules system and is unfavorable for developing countries such as China to participate in multilateral trading^[6]. If China intends to take the U.S. “Chip Act” to the WTO dispute settlement mechanism, the reform of the existing subsidy rules will provide

a more solid basis for China to win this dispute. Therefore, in future WTO subsidy rules reform process, China must take a more active stance to effectively promote and even lead the WTO subsidy rules negotiations from the starting point of safeguarding its own trade interests and promoting fair trade.

China's reform proposals on subsidy rules should combine active defense and a proactive approach. In recent years, the U.S., Japan, Europe, and other developed countries have argued that the SCM Agreement is not binding enough on subsidies, and thus advocated the restructuring of WTO subsidy rules, politicizing the issue of subsidies and linking it to non-market economy models or even political systems, with strong ideological focus. These advocates fundamentally deviate from the core value of WTO non-discrimination, making WTO a tool for developed countries to seek private interests. In this regard, China, should take an active defensive approach and resolutely oppose the introduction of country-specific discrimination rules as proposed by the U.S., Japan, and Europe in the negotiations, including ownership discrimination against state-owned enterprises and the abuse of external benchmarks for subsidies. On the other hand, China should take the initiative and make reciprocal and reasonable claims against developed countries on subsidies. Firstly, China should improve its transparency rules and urge developed countries to strictly fulfill their subsidy notification obligations. Secondly, China should improve the rules on trade remedies, clarify the rules and procedures of countervailing investigations, prevent the abuse of trade remedies, and promote the standardization of countervailing investigations. Thirdly, the special situation of developing members should be considered in the application of subsidy rules, so as to achieve relative equality in the application of rules among different members.

To sum up, under the rise of trade protectionism and the critical period of WTO subsidy rules reform, China should play a more constructive role to safeguard the multilateral trading system and the interests of developing countries in the negotiation of subsidy rules; promote the development of subsidy rules toward effectiveness, fairness, and transparency; curb the spread of the wave of anti-economic integration; and promote the development of the WTO multilateral trading system.

4.3. Proactive application of countervailing rules to improve China's trade remedy system

The WTO dispute settlement mechanism is a statutory safeguard of the WTO and an effective way to resolve trade disputes. However, as a member of the WTO, China has only completed its transition from passive response to active prosecution since its accession to the WTO in 2001 to the "copperplate case" in 2007, which is in sharp contrast to other WTO members, especially the U.S. and other western countries^[7]. It is worth noting that although China's initiative to prosecute the case is relatively small, there have been successful cases, among which the most typical one is the case of "United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China (DS379)." Therefore, when the U.S. introduced the "Chip Act" in an attempt to dominate the semiconductor market, China should change its passivity, take the initiative to apply countervailing rules at the international level, and improve its trade remedy legal system in order to cope with the current complex and treacherous international economic and trade environment.

From the perspective of international countervailing practice, it was only in 2009 that China applied countervailing measures for the first time despite having formulated the Foreign Trade Law as early as 1994 to include provisions for subsidies and countervailing measures^[8]. In most cases that have occurred, China has been passively involved in countervailing investigations, and the enterprises involved have mostly been imposed high countervailing duties or even passively accepted countervailing sanctions due to their lack of knowledge about countervailing. On the contrary, the U.S. and other developed western countries are the ones who initiated most of the countervailing investigations, but they themselves have been subject to few countervailing investigations. Based on the above phenomenon, China should learn from the experience of western countries, take initiative in the international arena, actively apply

countervailing rules, initiate countervailing investigations against other countries' subsidies that are suspected of violating WTO subsidy rules and damaging Chinese industries, as well as take unilateral countermeasures or resort to multilateral dispute settlement mechanisms when necessary.

On the other hand, the U.S. and other developed countries are able to launch frequent trade remedy investigations on China because they have a comprehensive domestic trade law and legal system, which can provide sound legal support for the protection of local enterprises. On the contrary, China's trade remedy legal system is relatively weak, and its efforts to initiate trade remedies as a complainant country are limited. With regard to this, China should make more efforts not only to explore the use of existing international rules on trade remedies, but also to improve its trade remedy laws and regulations as well as respond to trade frictions by strengthening the rule of law to safeguard its own interests and industrial security.

5. Conclusion

The introduction and implementation of the U.S. "Chip Act" is a derivative and concrete manifestation of the prevailing unilateral protectionism in the international community and the traumatic impact on the WTO multilateral trading system. The U.S. "Chip Act" consists of three main parts. Among them, the bill for China and other "foreign countries of concern" has set several restrictive provisions in an attempt to curb the development of China's and other countries' semiconductor industry. Under the existing WTO rules, the U.S. "Chip Act" has a series of problems, including the constitution of an actionable subsidy and the violation of the most-favored-nation treatment and national treatment principle. In order to safeguard the multilateral trade order and national interests, China should actively exercise the rights granted by the WTO, including specific measures to help resolve the crisis of the Appellate Body, promote the reform of the dispute settlement mechanism, participate in subsidy reform negotiations, actively contribute Chinese solutions, and take the initiative to apply countervailing rules and improve China's own trade remedy system.

Against the background of the rise of unilateral protectionism and the weak multilateral trading system, the fiscal measures of the U.S. "Chip Act" are only one of the manifestations of the current anti-globalization and anti-economic integration. Therefore, it is of great significance to deter unilateral protectionist forces, resist the wave of anti-economic integration, and maintain the operation of the multilateral trading system by promoting the improvement and development of the WTO and other multilateral trading systems as well as using the rights and means granted by it to timely qualify and curb the above fiscal measures.

Disclosure statement

The author declares no conflict of interest.

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