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U.S.-China Trade Relations Heat Up Post Trump Visit

Article By:

Robert S. Wang

By official accounts, President Trump's November visit to China went off well with positive atmospherics, including an unprecedented (for a foreign leader) dinner inside the Forbidden City and the signing of over $250 billion of commercial deals and two-way investment agreements. On the other hand, most western analysts have quickly pointed out that much of this was symbolism since most of the commercial deals were already or projected to be in the pipeline and many of the agreements were in the form of memoranda or letters of intent yet to be finalized. More importantly, they noted that there was no commitment on the part of China to undertake major policy and structural reforms that would significantly open up market access or improve the foreign investment environment in the country. Even the subsequent announcement by China that foreign financial firms would eventually be allowed to operate as wholly-owned foreign enterprises indicated there was "no specific timetable" for lifting the equity ownership limit. Current restrictions have "left foreign banks with a combined market share of just 1.5 percent of the Chinese banking system's assets" (NY Times, Nov 7, 2017) and foreign insurance companies at around the same level.

Recent U.S. Trade Actions toward China

Shortly after the visit, the U.S. Commerce Department announced (on Nov 28) that it would self-initiate "historic antidumping and countervailing duty investigations on common alloy aluminum sheet from China." In the press release, Commerce Secretary Ross stated that "we are self-initiating the first trade case in over a quarter century, showing once again that we stand in constant vigilance in support of free, fair, and reciprocal trade." In this process, the International Trade Commission (ITC) is expected to make preliminary injury determinations on or before January 16. Assuming positive findings, Commerce could announce preliminary countervailing duties (CVD) by February and antidumping duties (AD) by April of 2018, with the immediate collection of these duties (as cash deposits) by customs authorities on an estimated $600 million of Chinese aluminum sheet imports. Final ITC determinations would be made a few months afterwards.

Two days later, the United States made public that it had just submitted a third-party brief to the WTO in support of the European Union (EU) position against the recognition of China as a "market economy" despite the expiration last year of relevant provisions contained in China's 2001 WTO accession protocol. The United States and EU both argued that the continuing pervasive role of the state in the Chinese economy, especially the use of large scale subsidies, has seriously distorted domestic prices, hence necessitating the continued use of third-country price comparisons in antidumping cases. Earlier in June, underscoring the broad significance of this action, US Trade Representative (USTR) Robert Lighthizer told Congress that this case was “the most serious litigation we have at the WTO right now” and a decision in China’s favor “would be cataclysmic for the WTO.” On the same day of this announcement, U.S. Treasury undersecretary David Malpass told an audience in New York that “China’s industrial policy has become more and more problematic for foreign firms” and that “huge export credits are flowing in non-economic ways that distort markets.” “The WTO has shown an inability to resolve disputes, limit subsidies or draw China into the market status that was envisioned when China joined the WTO,” he stated.

Meanwhile, the Trump administration is expected to complete a number of earlier trade actions in the coming year, including two Section 232 (national security) investigations on steel and aluminum, one Section 201 (safeguard) investigation of Chinese solar cells and modules and, more broadly, a Section 301 investigation of China’s policies regarding transfers of technology, intellectual property, and innovation. In initiating the Section 301 investigation in August, the USTR pointed to growing frustration with respect to Chinese policies and practices that “reportedly deprive U.S. companies of the ability to set market-based terms in licensing and other technology-related negotiations with Chinese companies and undermine U.S. companies’ control over their technology in China.” The notice pointed specifically to China’s “strategy to become a leader in a number of industries, including advanced technology industries, as reflected in China’s ‘Made in China 2025’ industrial plan.” Under Section 301, President Trump would potentially have the power to impose broad sanctions against Chinese imports and take other actions if a negotiated settlement is not reached that addresses U.S. concerns.

How will China respond?

China has responded quickly and sharply to these recent U.S. trade actions. At a briefing on December 1, China’s Foreign Ministry spokesman said that “the practice of using a third country to measure the cost of Chinese products in anti-dumping cases must end,” and that the opposition to granting China market economy status “harked back to the cold war.” (South China Morning Post, Dec 1, 2017) In the same article, a senior researcher with a government think tank was quoted as saying that “the China hawks in the Trump administration had been plotting the recent moves, which were part of U.S. efforts to contain China’s rise on the world stage.” She added that “the competition between the two countries will be a permanent fixture….and the balance of power is now tilting towards China.” The following week, a Chinese Commerce Ministry official said that the U.S. rejection of China’s market economy status “undermines the seriousness and authority of multilateral rules.” (Xinhuanet, Dec 4, 2017) Another researcher was quoted as saying that “the U.S. rejection reflects its panic and ideological prejudice.”

It is quite clear from these initial responses that China does not intend to respond positively to U.S. pressure or to undertake significant market reforms at this time. In fact, President Xi Jinping had just re-affirmed the leading role of the party and the state in the economy at the recently-concluded 19th Communist Party Congress in October, just before Trump’s visit to China. Xi called for further measures to support, consolidate, and make more efficient China’s debt-laden state-owned enterprises, and focused on government industrial policies to promote technological advances, innovation, and “national champions,” as laid out in the government’s “Made in China 2025” report. While calling for continued “reform and opening,” Xi proposed setting up more special economic zones to attract foreign high-tech companies into strictly-confined areas of the country, essentially following the pattern of China’s economic development since 1979. Thus, while the market can play a role in the economy, China’s economic policies will continue to be led by the state under this touted model of “socialism with Chinese characteristics.”

As on many occasions in the past, China is thus expected to threaten retaliation against U.S. companies that benefit from the current bilateral trade relations in order to mobilize them against new U.S. trade sanctions. Shortly after the USTR announced its Section 301 investigation in August, a government-owned media reported that “a full-blown trade war between China and the United States still doesn’t seem inevitable, but that shouldn’t prevent Beijing from taking measures to cope with the U.S.’ trade protectionist weapon: Section 301.” (The China Daily, September 5, 2017) Analysts expect that China would threaten to stop buying aircraft and agricultural products from the United States or impose its own antidumping duties on U.S. imports. (SCMP, Dec 5, 2017) In 2016, China accounted for 62% of U.S. soybean exports, 14% of U.S. cotton exports, and 25% of U.S. aviation exports. (Business Insider, August 18, 2017) Some have suggested that China could also cancel aspects of the “100 Day Plan” trade agreement reached shortly after the Xi-Trump Florida summit, in which China agreed to lift the ban on U.S. beef imports and expand access for certain U.S. financial institutions.

Heading Toward a Trade War?

At this point, given recent U.S. trade actions and China’s response thus far, it is almost certain that trade tensions will increase, but will this lead to a large scale trade war? The immediate question is whether the Trump administration will in fact move ahead to impose serious tariffs and quotas on Chinese imports, pending the completion of its various ongoing investigations. Assuming the investigations validate the premise of recent U.S. trade actions, i.e., that China’s interference in the market has seriously distorted prices and violated U.S. intellectual property rights, the Trump administration will have to take appropriate action to enforce U.S. trade laws or quickly lose credibility especially via-a-vis the Chinese. In fact, President Trump himself noted in a public speech in Beijing that “trade between China and the United States has not been, over the last many, many years, a very fair one for us.” Instead of directly criticizing China, however, Trump “blame(d) past administrations for allowing this out of control trade deficit to take place and to grow.”

As in the past, however, there are likely to be strong concerns and opposition among many in the U.S. business community to the Trump administration taking strong trade remedy actions that could result in China retaliating against their exports or businesses in China. Fully aware of this, China can be expected to use its increasingly large and attractive domestic market as leverage against U.S. trade sanctions. Additionally, U.S. retail and downstream companies that benefit from low-priced Chinese imports (whether dumped or not) are also likely to oppose increased U.S. tariffs or quotas against these imports. It is uncertain at this time how the Trump administration will balance these interests and concerns. Given recent statements by senior administration officials, however, it should not be a surprise to see new U.S. trade sanctions against a range of Chinese imports in the coming months.

Assuming the United States does follow through with trade sanctions, one would expect China to retaliate, directly or indirectly, against U.S. imports and businesses as it has in the past. The only question is how and to what extent China will do so. On the issue of China’s non-market economy status, the fact that the EU and the United States are aligned in making the point that, purely as a matter of fact, China’s state-dominated economy does not allocate investment resources through market economy mechanisms, probably limits the degree to which China can justifiably introduce retaliatory measures focused on these actions. Moreover, while it is still unclear how significant U.S. trade sanctions in these cases will be (especially those related to Section 301), they are likely to have a relatively limited impact on China’s overall exports to the United States. An overreaction on China’s part could backfire and lead to further U.S. responses and eventually escalate into a more serious trade war, in which both have much to lose. In 2016, the U.S. market accounted for about

20% of China's total exports while U.S. exports to China accounted for about 8% of overall U.S. exports. Moreover, despite its rapidly expanding domestic market, China's total exports continue to represent nearly 20% of its GDP, as opposed to about 12% for the United States.

On a more positive note, while increased trade tensions could eventually lead to a trade war with dire consequences for both, they would also highlight the need for both sides to address the fundamental issues in our trade relations more urgently. As China's ambassador to the United States urged in a press briefing just prior to Trump's visit, bilateral trade disputes should be handled in a "very constructive and pragmatic manner," so as not to "undermine the overall relationship." Hopefully, the very real risk of a trade war will prompt the Chinese government to accelerate the reform agenda issued at the Third Plenum of the 18th Party Congress in 2013. In its communique, the first major policy blueprint after President Xi took office, the Party laid out a bold agenda for deepening economic reforms "to allow the market to play a 'decisive role' in the allocation of resources" and stated that "both the public and private sectors are the same important components of a socialist market economy." In this connection, for example, the Section 301 investigation can be seen as an opportunity for China and the United States to work together to develop the rules of the road limiting government support and subsidies to high tech industries and ensuring a level-playing field for all companies, foreign or domestic, and public or private. Such efforts would enhance market reforms that will go a long way to stabilize and strengthen overall U.S.-China economic relations.

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