

中美研究中心 ICAS Issue Primer

Topics in U.S.-China Relations

Issues in 2018: An ICAS Preview

U.S. China Economic & Trade Ties: Expect Heightened Tensions in the First Half of 2018

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Key Takeaways

- With a large bilateral trade deficit and little to show in terms of progress within the U.S.-China Comprehensive Economic Dialogue (CED) process, U.S.-China trade ties are headed for a period of elevated friction during the first half of 2018. **President Trump is expected to pivot away from his mainstream economic advisors on China trade policy** (Gary Cohn, Steve Mnuchin, Wilbur Ross) during the first half of 2018 **and embrace the economic nationalist - and unilateralist - recommendations of U.S. Trade Representative (USTR) Robert Lighthizer**, which align closely with the president's views.
- The upcoming completion of two key China-related investigations will likely provide the platform for a tougher Trump administration stance towards China. The Section

301 investigation of Chinese technology transfers, intellectual property rights (IPR) and innovation practices, which is due during the first half – and perhaps first quarter - of 2018, will serve as the key vehicle for this policy shift. Although, USTR has until August 14, 2018 to conclude this ‘self-initiated’ investigation, **it will be concluded much in advance and, on balance, will likely result in the imposition of unilateral – and perhaps significant - trade enforcement measures against China.**

- The other key investigation – regarding whether steel imports constitute a threat to U.S. national security (**Section 232 investigation**) – **is unlikely to result in the imposition of trade remedy measures.** With the U.S. Department of Defense demanding extensive carveouts from remedy measures that effectively defeat the purpose of the Section 232 investigation, **the administration is instead likely to turn towards ‘self-initiating’ anti-dumping and countervailing duty cases involving Chinese exporters with greater frequency.**
- The Trump administration made a **series of troubling trade policy moves** during the last two months of 2017, which suggest that the groundwork is being laid for a toughened stance on trade with China. When the Section 301 and Section 232 investigations as well as other China-related cases come due, and decisions on enforcement measures are being made, these policy actions will feed into that decision-making process.
- **Currency and foreign inward investment** concerns will remain a second-tier concern in U.S.-China relations during this period. It is worth noting that measures which subject Chinese inward investment and acquisitions proposals to heightened intra-agency scrutiny will, nevertheless, likely advance in the U.S. Congress, and become a first-order issue during the second half of 2018.

The Elevation of Robert Lighthizer within the Trade Policy Debate

1. The **renegotiation of the North America Free Trade Agreement (NAFTA) will be the Trump administration’s single most pressing trade policy agenda item during the first half of 2018.** In April 2018, Congressionally-delegated Trade Promotion Authority (TPA) will expire - unless reauthorized. In July, Mexico will hold presidential elections and the current frontrunner, Andres Manuel Lopez Obrador, is a populist, left-leaning candidate who has called for NAFTA renegotiations to be suspended until the elections. Unless significant progress is made during the first quarter of 2018 – *and at this time the renegotiations are proceeding poorly*, Donald Trump is expected to issue the required 6-month prior notice of withdrawal from NAFTA. **In any case, the renegotiations will significantly tie-up USTR’s bureaucratic resources during this critical period.**

2. **Next to the NAFTA renegotiations, U.S.-China trade relations will be the Trump administration's other most important trade policy agenda item during the first half of 2018.** With a large bilateral trade deficit and little to show by way of progress within the U.S-China Comprehensive Economic Dialogue (CED) process, **bilateral ties are headed for a period of elevated friction during this period.** Bilateral ties were last headed towards a period of tension at this time last year when President-*elect* Trump vowed to get tough on China for its supposedly unfair trade and currency practices, which he claimed had led to a large U.S. trade deficit with China. The tensions were averted following a successful summit at Mar-a-Lago, where President Trump resolved to give his mainstream economic advisors on China trade policy (Gary Cohn, Steve Mnuchin, Wilbur Ross) an opportunity to rectify the imbalances in the bilateral economic relationship through negotiations, and other, less aggressive means.

3. These approaches have largely failed, and **President Trump will likely pivot away from the policy recommendations of his mainstream economic advisors** during the first half of 2018. Instead, he will likely adopt **the views, and recommendations, of USTR Robert Lighthizer.** In fact, there are indications, ranging from Lighthizer's prominent role during delegation-level talks during Trump's Asia-Pacific trip to his unique role during the drafting of the administration's recent *National Security Strategy*, that this shift has already occurred.



4. **Lighthizer's economic nationalist, and unilateralist, views align closely with President Trump's own leanings - and Candidate Trump's campaign promises - on the need to impose punitive trade enforcement measures on China to address the bilateral deficit.** Lighthizer's trade policy objectives vis-a-vis China revolve entirely around protectionism: strengthening trade remedies laws; providing safeguards relief to industry; treating China as a non-market economy for anti-dumping purposes; and bringing additional cases against China at the World Trade Organization (WTO). **Alarmingly, Lighthizer has strongly suggested that the United States might ignore a WTO ruling if it were to favor Beijing in a China-related 'non-market economy' and/or anti-dumping case.** His recommendations following the Section 301 investigation on China's IPR practices will likely reflect these unilateralist and protectionist beliefs.

Key On-Going Enforcement-related Investigations

5. **SECTION 301 IPR Investigation:** On August 14, 2017, USTR Lighthizer ‘self-initiated’ an investigation of Chinese technology transfers, intellectual property rights (IPR) and innovation practices under Section 301 of the Trade Act of 1974. **Under the statute’s timeline, USTR has until August 14, 2018 to submit its report.** Although it has been less than 150 days since the investigation was launched, there are already signs that the administration could release its conclusions and move into the remedy phase of the probe during the first half – or even first quarter – of 2018. **A draft report has been completed which is now being shared within the interagency committee overseeing the investigation.**
6. The speed with which the investigation appears to have moved ahead is not surprising. USTR releases a **‘Special 301 Report’ on an annual basis**, and the 2017 edition had a 10-page section devoted to China. China is a ‘Priority Watch List’ country, according to USTR’s global classification of countries’ IPR practices. China’s IPR practices are also routinely surveyed – and criticized – in the **annual National Trade Estimate Report on foreign trade barriers**. Hence, compiling the Section 301 draft so quickly is not unexpected.
7. Since the late-1990s, USTR has interpreted Section 301 to require that any alleged violations of U.S. rights first be taken up within the WTO’s dispute settlement mechanism. As such, USTR has not imposed unilateral sanctions under Section 301 authority since the late-1990s. Instead it has taken its case to the WTO Dispute Settlement Body (DSB). It remains to be seen if USTR Lighthizer will follow this precedent. **The prevailing consensus is that he will do exactly the opposite and propose harsh unilateral Section 301 trade enforcement measures against China.** These remedies *might* be announced as early as the end of the first quarter of 2018 and will likely be heavy-handed. If so, it will almost certainly elicit a retaliatory Chinese response.
8. If USTR Lighthizer does follow precedent (which is not likely) and initiates an IPR-related Section 301-based case at the WTO’s DSB, USTR could argue that as per China’s accession commitments ‘enforcement is supposed to mean enforcement’ and China – by tolerating the wide infringement of IPR laws that exist on the books – is failing to meet its positive WTO enforcement-related obligations. Another basis for challenge is that China, by coercing foreigners out of their IPR rights, is failing to administer its laws and regulations in an “impartial” and “reasonable” manner, as required by the WTO. **It remains to be seen if USTR can construct a credible case, and it is by no means certain that it can. If it could, it would have brought a slew of cases much earlier on.** For instance, in related areas where it had a robust case, such as electronic payments,

USTR did not hesitate to bring its case to the WTO, and proceeded to win a favorable award.

9. **SECTION 232 Steel Investigation:** On April 20, 2017, the Trump administration initiated a sweeping investigation to determine whether Chinese steel imports threaten American national security. **Under the Section 232 timeline, the U.S. Commerce Department has until January 14, 2018 to submit its report with recommendations to the president.** The operating assumption in Washington is that Secretary Wilbur Ross at Commerce has waited to release the report until *after* tax reform legislation was passed. With Republicans holding a razor-thin majority in the U.S. Senate, the Trump administration did not want to lose any Republican votes arising from China's retaliatory threat of action in case Trump imposed remedies on imported Chinese steel.
10. In fact, the Section 232 investigation appears to have run into trouble within the U.S. inter-agency vetting process. **The main objection has been put forward by the U.S. Department of Defense (DoD). DoD's main objection is that the trade restrictions proposed by the Commerce Department in the draft report would contravene defense sector agreements that the United States has with many of its allies and would unnecessarily damage these alliances.** These agreements aim to promote standardization in both countries' procurement of defense equipment by waiving U.S. restrictions on imported inputs and goods from that ally which are used in military applications - thus easing their access to the U.S. defense market.
11. As such, DoD has asked for significant carveouts for its allies, and the **Commerce Department is currently considering remedy exceptions for Australia, Mexico, Canada, the United Kingdom, Japan and South Korea.** However, **these carveouts will defeat the very purpose of the Section 232 investigation.** China only provides three percent of all U.S. steel imports. In fact, China did not even break into the top 10 sources of U.S. steel imports in the first half of 2017. Of the top 10 steel exporters to the United States, half are countries with which the United States has mutual defense agreements. Canada provides 17 percent of U.S. steel imports, and Germany, South Korea, Taiwan and Japan are all bigger suppliers than China.
12. If the Section 232 steel investigation ultimately turns out to be a flop, **the Trump administration will most likely turn towards 'self-initiating' anti-dumping and countervailing duty (AD/CVD) cases against non-allied foreign exporters, including China, with greater regularity.** Both Robert Lighthizer (in the Section 301 instance) and Wilbur Ross (in the aluminum alloy sheets anti-dumping instance – *see next section*) have shown that they are not shy to self-initiate cases. Categories of domestic steel products that are under the greatest import pressure will be provided temporary protection through AD/CVD duties. Government procurement (Buy American) laws could also be

passed requiring DoD to purchase steel-based products from manufacturers that are part of America's technology and industrial base.

Hardening Trade Policy Actions

13. During the last two months of 2017, the Trump administration took a number of troubling China-related trade policy steps – some of which will feed into the decision-making process when the Section 301 and Section 232 investigations come due and decisions on enforcement measures are made.



14. On November 28, the U.S. Commerce Department announced a **'self-initiated' anti-dumping investigation into imports of common aluminum alloy sheets from China. This is the first such self-initiated case in 25 years.** The Commerce Department will treat China as a 'non-market economy,' while computing production costs to determine fair market value for the (supposedly) dumped products. Using the 'non-market economy' methodology in anti-dumping cases after December 11, 2016 (the 15-year anniversary of China joining the World Trade Organization) is contrary to the U.S.' WTO obligations. **The 'self-initiated' investigation will most-likely be the first of many such 'self-initiated' anti-dumping and countervailing duty (AD/CVD) investigations by the Commerce Department.**

15. During the last week of November 2017, USTR laid out a detailed legal argument for **continuing to treat China as a 'non-market economy.'** The legal justification was laid out in a third-party submission that sided with the European Union (EU) in a WTO case that was brought against the latter by China. **The essence of USTR's argument is that Article VI of the *General Agreement on Tariffs and Trade (GATT)* – and not *China's WTO Protocol of Accession* – provides the authority to reject home market prices and costs in anti-dumping cases if those data are not determined under market economy conditions. In USTR's view, expiration of Section 15(a)(ii) of *China's WTO Accession Protocol* only requires the defendant country (in this case, the EU) to bear the burden of providing the evidence that the Chinese industry in question does not operate on market principles.** This interpretation will almost-certainly be challenged at the WTO.

16. On October 26, 2017, the Commerce Department laid out a **200-page memo titled “China’s Status as a Non-Market Economy” (NME), arguing that China is not a market economy under U.S. law for anti-dumping purposes.** Commerce conducted a six-factor analysis of key aspects of China’s economic structure to support its case: of China’s currency convertibility regime; its wage determination regime; foreign inward investment regime; SOE regime; industrial policy regime; and legal system. **The purpose of this memo is to provide that burden of proof regarding China’s NME status, consistent with USTR’s interpretation of Section 15(a)(ii) of China’s WTO Accession Protocol.** When China files a case against the United States at the WTO in 2018 against the latter’s non-compliant use of the NME methodology in the context of an anti-dumping-related legal challenge, USTR will use this memo as a basis to construct its legal argument.
17. On November 30th, the 33 countries participating within the G20-initiated **Global Forum on Steel Excess Capacity** issued their final report in Berlin, which outlined six guiding principles to reduce overcapacity in the sector. **The United States expressed disappointment regarding the results** and, on December 12th along with the EU and Japan, **announced a new trilateral cooperative front to challenge overcapacity in China’s steel sector, as well as the state financing and subsidies that fuel it.** America’s unfavorable view of the deliverables coming out of the G20s Global Forum on Steel Excess Capacity will have a significant impact on on-going and future steel trade remedy cases, including the Section 232 steel investigation.
18. On October 17th, the U.S. Treasury Department released its most recent semi-annual currency report. **No country was listed as a ‘currency manipulator,’ although five countries, including China, were placed on the Monitoring List.** China should never have been placed on this list for the simple reason that China did not meet two of three criteria to be placed on the list. It was nevertheless listed because the size of the bilateral goods trade deficit continues to be disproportionately large. **This pattern of being placed on the Monitoring List, but not being declared a ‘currency manipulator’ is expected to remain unchanged during the next semi-annual cycle in Spring 2018.**
19. On November 8th, **the Foreign Investment Risk Review Modernization Act - a bill to review, upgrade and expand the scope of CFIUS (Committee on Foreign Investment in the United States) was introduced in Congress.** The bill aims to markedly augment the oversight of, both, inward investment and acquisitions of U.S. companies by Chinese entities, as well as restrict China-destined *outward* investment and technology transactions by U.S. firms. Both Defense Secretary Jim Mattis and Treasury Secretary Mnuchin, the nominal head of CFIUS, have endorsed this legislation. The legislation is currently being deliberated on and is facing scrutiny regarding its overly-expansive mandate envisioned for CFIUS. In its current form, it is unlikely to become law. **This**

having been said, the sentiment against Chinese acquisitions in the United States is on the rise, and China-related inward investment concerns will become a first-order issue during the latter half of 2018. Chinese companies' bids for U.S. firms that are currently on CFIUS' radar are expected to remain on hold or be rejected in the interim.

20. The Trump administration did not file any WTO cases against China in 2017, despite his campaign promise to “bring trade cases against China both in this country and at the WTO.” By contrast, the Obama administration had launched four cases against China during its final year in office. The Trump administration did initiate 82 anti-dumping and countervailing duty (AD/CVD) investigations during its first year, a sharp increase from 2016, and the most in at least a decade. A number of those AD/CVD cases were directed against Chinese exporters, including the first ‘self-initiated’ probe in 25 years.

Conclusions

21. U.S.-China trade and investment ties are re-entering an elevated phase of friction. As early as mid-January, the remedies that President Trump will impose in a **Section 201 Safeguards case related to solar cells and modules** is expected to be announced. Already, the ground is being cleared for a defense of the expected remedy and the subsequent Chinese case challenging the remedies at the WTO. On December 27, 2017, the U.S. International Trade Commission (USITC) laid out legal reasonings alleging China's state-driven subsidization and alleged non-compliance with WTO obligations as an “unforeseen development” that contributed to the surge in solar imports and subsequent injury to U.S. industry. Separately, in late-December, **a bid by Ant Financial Services Group, an affiliate of the Chinese tech giant Alibaba Group, to acquire the U.S. financial services firm, MoneyGram, was called off** due to inability to satisfy national security-related concerns put forth by CFIUS.
22. The sheer volume of these and other aggressive trade and investment policy actions in advance of the completion of the various China-focused investigations do not bode well for the bilateral relationship. Robert Lighthizer's recently upgraded role in the Trump administration is a particularly ominous sign of things to come. Although nothing is set in stone, the first half of 2018 will likely witness a period of elevated friction in U.S.-China bilateral economic relations.