

# Addressing Challenges in U.S.-China Trade Relations

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# Overview

- Overall Context: Big Upsides & Big Concerns
- Disturbing Developments & Recent Headlines
- Underlying Causes of Frictions
- Core U.S. Trade Policy Goals
- Available Tools
- Perplexing Dynamics
- Achieving Results

# Big Upsides & Big Concerns

## Upsides: U.S. Perspective (*examples*)

- From 2002-08, bilateral trade in goods tripled; services trade doubled.
  - U.S. goods exports to China average increase 20.4% / year
  - Cf. overall U.S. goods exports average increase 8.6% / year
- During 2009
  - U.S. global goods exports declined by 17.9%
  - U.S. goods exports to China declined by 0.2%  
*(U.S. goods imports from China declined by 12.2%)*
- China now our 3rd largest export market & 2nd largest trading partner

# Big Upsides & Big Concerns

## **Upsides:** U.S. Perspective (*examples*)

- China is strategically important market for U.S. industries, e.g., China estimated to purchase 3,380 new commercial aircraft over next 20 years = \$350 billion
- Per pre-financial crisis US-China Business Council survey, 87% report operations profitable; 93% view medium-term prospects positively.

# Big Upsides & Big Concerns

## **Upsides:** Chinese Perspective (*examples*)

- U.S. market key Chinese export destination
- Investment by U.S. companies key contributor to China's economic growth, technological advancement
- Reform & opening has lifted 100's of millions in China from poverty.

# Big Upsides & Big Concerns

## Concerns: U.S. Perspective (*examples*)

- IPR Infringement
  - 81% of counterfeit goods seized at U.S. border are from China.
- Market-distorting Policies & Practices
  - Central and local governments have supported large new investments, while unemployment concerns have led to continued support for non-competitive enterprises
  - Result is significant, rapidly increasing overcapacity in various sectors, which has -
    - Driven down margins and led Chinese companies to pursue aggressive export plans
    - Forced U.S. companies to compete on uneven playing field in China, the U.S. and other markets.

# Big Upsides & Big Concerns

- **Fostering National Champions**

- 7 industries to be “absolutely controlled by state-owned enterprises”<sup>1</sup>
- SOE’s to maintain “relatively strong controlling position” in certain infrastructure and “pillar” industries <sup>2</sup>
- Leads to industrial policies fostering “discriminatory” practices

- **Transparency**

- Limited opportunity for prior comment on proposed rules, and overall opacity of administrative decision-making.

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<sup>1</sup> armaments, power grid and distribution, petroleum and petrochemical, telecommunications, coal, civil aviation, shipping.

<sup>2</sup> equipment manufacturing, automobiles, electronic information, building, iron and steel, nonferrous metals, chemicals

# Big Upsides & Big Concerns

## **Concerns:** Chinese Perspective (*examples*)

- U.S. Policies that could undermine China's economic growth and treat China less favorably than other countries
  - Not granting Market Economy Status (MES) to China
  - Country-specific safeguard applicable only to China (Sec. 421)
  - Pressure to adhere to higher standards than U.S. expects of other countries at China's level of economic development.
  - U.S. export controls applicable to China
  - CFIUS and other rules that “discriminate” against state-owned enterprises
  - Remaining Tiananmen Sanctions (e.g., OPIC, satellite launches)



# Disturbing Developments

- U.S. Concerns

- China's Nov. '09 measures supporting indigenous innovation
- Negative view of China's conduct at Copenhagen
- Google's allegations and partial withdrawal from China
- Trial of Rio Tinto executives / Australian consular officials excluded from closed portion of trial

- Chinese Concerns

- Increase in trade remedy cases against imported Chinese products
- Increased pressure on China to modify currency policies
- Rising negative sentiment among foreign business community

# Recent Headlines

- “China Knows the Time for Lying Low has Ended” [FT 28 Mar 10]
- “China: Closing for Business?” [Business Week cover story 25 Mar 10]
- “U.S. Firms Feel Shut Out in China” [WSJ 22 Mar 10]
- “China Warns Against U.S. Trade Sanctions” [DJ 21 Mar 10]
- “Business Sours on China: Foreign Executives Say Beijing Creates Fresh Barriers” [WSJ 17 Mar 10]
- “House Members Urge Action Against China” [WSJ 15 Mar 10]
- “Newly Powerful China Defies Western Nations with Remarks, Policies” [WP 15 Mar 10]
- “It’s China’s World, We’re Just Living in It” [Newsweek 12 Mar 10]

# U.S. Perspective: Four Underlying Causes of Frictions

1. Chinese Macroeconomic Policies Leading to Unbalanced, Resource-intensive, Export-oriented Growth
2. Chinese Policies Supporting Nationalistic and State-led Economic Development
3. Systemic Weaknesses Related to China's Current Level of Economic Development
4. Weaknesses in Accountability, Transparency and Rule of Law Related to China's Political System

# China's Challenges

- **Macro Policies:** Financial crisis highlighted unsustainability of policies contributing to macroeconomic imbalances and relying on export-driven model of economic growth.
  - Chinese leaders see need to reform, but especially difficult during financial crisis.
- **Industrial Policies:** China appears to have shifted, over past few years, from focusing on WTO principles to promoting “China model” of economic growth.
  - Conflicting interest in using WTO to fight against protectionism and seeking maximum flexibility to pursue industrial policies.
  - Industrial policies sometimes successful during “catch-up” period of economic development, but can China avoid difficulties ultimately faced by Japan?

# Core U.S. Trade Policy Goals

- Improved market access in China for U.S. goods, services & investment to address imbalances in the bilateral relationship
- Modification of Chinese policies that “unfairly” advantage Chinese suppliers of goods & services in China, the U.S. and other markets
- Improved enforcement of intellectual property rights and product safety, environment and labor standards in China
- China’s assumption of responsibilities in the WTO commensurate with its standing as a global trading power

# Available Tools

- WTO litigation
- Trade Remedies Available under Domestic Law
- Dialogue (especially the JCCT and S&ED)
- Negotiation of Bilateral Agreements (e.g., BIT)
- Multilateral Initiatives (e.g., in WTO, APEC)
- Coordinated Efforts with Other Like-Minded Trading Partners

# Perplexing Dynamics

1. Chinese and U.S. leaders agree on many goals but also disagree on important issues where one country's decisions could have significant negative impact on the other, *e.g.*:
  - Appropriateness of China's state-led economic development model designed to foster national champions
  - Currency policies of both countries

**Challenge:** Persuading leaders of the other country to modify problematic policies.

# Perplexing Dynamics

2. Even where both countries agree, they often are unable to implement needed changes in the near term, e.g.:
  - **China:** Developing political/regulatory/legal/financial infrastructure required to foster market economy and rule of law can legitimately take many years.
  - **U.S.:** Both countries agree that the U.S. should reduce its budget deficit, but this will not happen overnight.

**Challenge:** Distinguishing lack of capacity vs. lack of appropriate level of commitment and effectively addressing one or the other as needed.



# Perplexing Dynamics

3. Where one country is genuinely unable to implement needed reforms quickly and its request for patience might seem reasonable, the other country nevertheless cannot be overly patient because of significant harm to its interests, *e.g.*:

- U.S. losses due to inadequate IPR protection in China, problems with Chinese food & product safety, China's overcapacity in certain sectors.
- China's losses during period that executive branch worked to achieve change in law that banned imports of Chinese poultry.

**Challenge:** Coping while the other country implements needed reforms.

# Perplexing Dynamics

4. Leverage to compel or pressure the other country to change its policies is limited.
  - China believes it has substantial leverage and doesn't believe U.S. would adopt harsh measures.
  - Neither side wishes to launch a trade war.
  - WTO disciplines are helpful, but at the same time:
    - They preclude many unilateral actions to pressure trading partners.
    - Many problems not amenable to WTO litigation.
  - Bilateral cooperation also needed in non-economic arenas.

*“We are a poor developing country and unless you treat us as such, we will use our enormous economic and political clout to retaliate.”*

# Perplexing Dynamics

5. Cultural, historical and political differences and competing interests greatly complicate efforts to develop trust needed to achieve collaborative solutions to problems.
  - **National Pride** – Impact of China feeling it has been treated unfairly during past 170 years and held back from achieving due status as major world power vs. US confidence as superpower
  - **Fundamentally Different Political Systems** – Different approaches regarding: leadership selection, accountability & legitimacy; transparency and rule of law.
  - **China Simultaneously Undergoing Multiple Transitions**
    - Planned economy → market-oriented economy
    - Isolated country → globally integrated country
    - Developing country → advanced developing country

# Achieving Results

## Key Judgments to be Made by Policymakers in Each Country:

1. If US and PRC economic interaction continues on present course, will results be wholly satisfactory for my country?
  - If yes, then counterproductive to rock the boat.
  - If no, then absent agreement with the other country to change course, some level of disruption must be introduced into the relationship to alter the status quo.
2. If disruption must be introduced to US-China bilateral trade relations, how, when, and how much?

*Critical to establish priorities and determine cost one is willing to incur to achieve them.*

# Achieving Results

## U.S. Should Expect Near-term Results Only If:

1. (a) Goal is feasible for China to accomplish in near term; (b) goal aligns with China's own plans; and (c) China wants to cooperate with you at that point in time; or
2. (a) Goal is achievable by China within desired time frame; (b) U.S. has powerful positive or negative leverage; (c) Chinese believe U.S. will use it; and (d) Chinese judge that this outcome is acceptable under the circumstances.
  - **Otherwise**, make result a long-term goal and use highly collaborative approach.
  - If not, U.S. will probably not achieve goal and credibility with Chinese and U.S. domestic constituency will suffer.

# Conclusions

1. Healthy and sustainable U.S.-China economic relations are critically important to both countries.
2. Significant frictions arise in the bilateral economic relationship due to differences in:
  - macroeconomic policies
  - industrial policies
  - levels of economic development
  - political systems
3. Each country must make judgments about changes, if any, needed to make the relationship work and be prepared to pay the price necessary to reach agreement.
4. We should foster political environment that makes agreement possible.