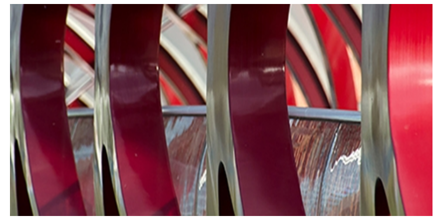
masuda funai



News & Types: Client Advisories

The Near Future of U.S. / China Trade

8/17/2020

By: Asa W. Markel

Practices: Commercial, Competition & Trade

Many companies doing business with China or sourcing materials, parts or products from China, have been hoping for the past two years that the current China / U.S. trade war would end soon, so that business as usual could resume. The overarching concern for many businesses affected by President Trump's increased Section 301 import duties has been cost. The cost of sourcing products and components from elsewhere, or the cost and time lag of transferring production operations to another country, has been deemed prohibitive by a number of industries. Even so, for many other industries, the mass exodus from China and her factories began in 2016 with the loss of local tax breaks for foreign manufacturing firms and continuing rises in local wages.

Yet, the China / U.S. trade war has also directly affected companies in third countries that do not source in China, and do not seek to import Chinese goods into the U.S. market. Overseas companies that utilize U.S. technology, or do business with Chinese entities being sanctioned by the U.S. Government, are coming under increasing pressure in the form of U.S. export controls. Again, a common sentiment among businesses is that these export controls may end either with the election of a new U.S. president or the signing of a new U.S. / China trade deal.

The continuing belief that the U.S. / China trade war is a short-term issue is probably not realistic. From 2002 to 2018, relations with China were dominated by business considerations. Since that time, political issues that had been left unaddressed, have come to dominate how more governments are dealing with China. It is important to keep in mind that for the past 20 years, the trading relationship between China and the world's major industrialized democracies has been framed by three major understandings:

- The 1989 arms embargo against China: this embargo remains in force in the U.S., European Union (E.U.) and several other major trading nations as a response to China's crackdown on protesters in Tiananmen Square;
- A widely expressed assumption by policymakers that increased trade with China would create a larger Chinese middle class that would result in a more open Chinese economy and civil society; and
- China's 2001 World Trade Organization (WTO) Accession Agreement: this agreement allowed China access to lower import tariffs from WTO members and the various WTO trading rights, in exchange for China's promise to open its economy to foreign trade.

Basically, WTO members gave China access to their trading club, including lower import tariffs, in exchange for the promise and expectation that other countries' business would be able to operate freely in the Chinese market. At the same time, arms sales to China have remained restricted by many countries for the past 31 years.

U.S. Secretary of State Mike Pompeo's July 23, 2020 speech on China has clearly articulated the U.S. Government's view that arms sales to China should still be restricted, China has not become more liberal through international trade and China has not lived up to its commitments. Ultimately, these are political decisions by Washington. However, the same views are increasingly being voiced by other governments.

European trade actions against China have generally been much more low-key than those of the U.S. However, pressure on Chinese export policies is mounting in the European Common Market as well. In June of last year, China's WTO litigation to force the E.U. to treat China as a "market economy" for purposes of anti-dumping import duty assessments collapsed and China quickly withdrew the case before a negative WTO ruling could be published. The position of other major economies, including the U.S., E.U. and Japan is that China has not achieved "market economy" status, in spite of its commitment to do so in its 2001 WTO Accession Agreement. Now that China no longer has the hope of a successful WTO lawsuit, in many industrialized markets, dumping margins for imports of Chinese origin commodities like steel, will continue to be calculated using pricing from more capitalist, third countries, rather than Chinese prices. The use of third country pricing will generally guarantee the continuation of import penalties on various Chinese commodity exports that are imported around the world at very low prices.

China's imposition of a new security law on the Hong Kong Special Administrative Region has prompted responses from Western governments that again relate to the above three basic understandings. The British, Canadian, Australian, German and New Zealand governments have already suspended their extradition treaties with Hong Kong, over concerns with the new law. Most of these governments are also announcing that the Chinese arms embargo is being extended to Hong Kong. The U.S. government has promised it will suspend its extradition treaty with Hong Kong as well and has revoked Hong Kong's privileged trade status. U.S. export control changes this summer have already removed exemptions for Hong Kong. In addition, both the U.S. and E.U. have begun sanctioning individuals and entities in China, with pressure mounting on the British government to do the same. The stated reasoning for these sanctions range from involvement in cyber espionage to human rights abuses. These sanctions are on top of restrictions placed in recent years in several countries on the use of Huawei and ZTE equipment for 5G telecommunications networks. In the meantime, India is in the process of blocking dozens and possibly hundreds of Chinese apps from operating in India.

In the business world, there are still some who believe that U.S. presidential elections this year may spell the end of the U.S. / China trade war. There is always that possibility. However, that possibility looks more and more remote. First, it is not just the U.S. government that is restricting technology transfers with Chinese firms, use of Chinese telecommunications technology or penalizing commodity dumping by Chinese exporters. Second, President Trump's challenger in the upcoming U.S. presidential election, Joe Biden, has publicly criticized Trump for not being hard enough on China. During the past month, the U.S. Senate passed a defense bill reaffirming support for Taiwan (in defiance of China) with a vote of 86 to 14. The last time the European Parliament voted on whether to retain the E.U.'s arms embargo on China, the vote was 373 in favor and 32 against. The simple fact is that in more capitals around the world, concern about Chinese practices has become a bipartisan issue. It will be very difficult to reverse this general trend.

The more prudent view should be that businesses will need to adapt to the following likely long-term realities:

- The embargo on arms sales to China will continue, which will continue to lead to tighter controls on high tech and “dual-use” (both commercial and military applications) items being transferred to China;
- Many key Western markets will be closed to or restricted for Huawei, ZTE and similar Chinese telecoms firms;
- More Chinese individuals and businesses will be subject to asset freezes and export sanctions implemented by multiple Western governments; and
- Antidumping duties will continue to be assessed against Chinese exports of steel, aluminum and similar commodities in the European, U.S. and other key markets.

On the other hand, the Trump Administration’s blunter instruments, like Section 301 import duties on Chinese origin goods or the proposed ban on travel by members of the Chinese Communist Party, may well be modified or ended under a Democratic president.

But, recent comments by the Australian and New Zealand governments may more accurately portend the future of the global economy. During the past month, both governments have participated in stricter measures on China. However, both governments have also been careful to state that their overall trade relationships with China are important to them. If U.S. policy does change in 2021, the U.S. is likely to also seek to strike a balance between its stated security concerns, and the need for free flow of goods and services in the global economy. Whatever the outcome of the U.S. election, the trend is for many governments to increase their scrutiny of China’s interactions with the rest of the world. This will continue to burden businesses with having to determine whether their transactions will be restricted or not.