Mapping the US-China Trade War
April 26, 2018

KEY POINTS:

1. **Treasury Secretary Mnuchin, USTR Lighthizer, Commerce Secretary Ross, and NEC Chairman Kudlow will travel to Beijing next week** for talks on trade issues in what appears to be the beginning, not the end, of a process of negotiations.
2. **Since January, the Trump administration has implemented a series of actions under Sections 201, 232, and 301** as part of its efforts to address what the administration believes are unfair Chinese trade practices.
3. The **extent of the fallout from 301 is not yet clear**, as much depends on success criteria for each side.
4. As part of its Section 301 action, **the administration is also expected to roll out further restrictions on Chinese investment** in the near-term under the International Emergency Economic Powers Act (IEEPA) and the Committee on Foreign Investment in the U.S. (CFIUS) reform and/or the Export Control Reform Act (ECRA) of 2018.

Below please find a primer on the trade and investment issues currently darkening the bilateral relationship with China. Treasury Secretary Mnuchin, U.S. Trade Representative (USTR) Lighthizer, Commerce Secretary Ross, and NEC Chairman Kudlow travel to Beijing next week for talks, but it's not clear that the administration has aligned on a China trade strategy. We expect the talks next week to be the beginning of a process, not the end of one, and that trade tensions will fester for the foreseeable future.

Washing Machines and Solar Panels (Section 201)

In January 2018 **the Trump administration implemented steep safeguard (201) tariffs on imported washing machines and solar panels**, the first in a series of steps designed to address what the administration believes are unfair Chinese trade practices.

The Chinese reaction was measured. Spokesmen from the Ministry of Foreign Affairs and **Ministry of Commerce condemned the move but signaled China would look to the WTO to resolve the issue.** In early February, China filed a request for consultations with the U.S. at the WTO regarding U.S. safeguard actions.

Steel and Aluminum (Section 232)

Under Section 232 of the Trade Expansion Act of 1962, **the president directed the Department of Commerce to initiate investigations into the effect of steel and aluminum imports on U.S. national security** in April 2017. In February of this year Commerce published the results of the investigation along with a report detailing recommended action. **Trump rolled out his decision on steel and aluminum import adjustments on March 8.** The administration announced that companies may apply for exemptions (the Tariff Exclusion Process) on March 18. Thousands of exclusion petitions have been filed to date at the Department of Commerce.

The Chinese immediately retaliated on an equivalent quantity of U.S. imports. On April 13, the U.S. accepted China's request to enter into consultations at the WTO on this issue.

Chinese Intellectual Property (IP) practices (Section 301)

USTR initiated an investigation into Chinese IP practices in August 2017, and those results became public on March 22. Following the conclusion of the investigation, **the Trump administration published a prospective list of $50 billion worth of Chinese exports to the U.S.** covered by increased tariffs.

The Chinese then released a prospective list of increased tariffs on U.S. exports of equal value, including politically critical soybeans and other agricultural products. Immediately thereafter, President **Trump directed the (USTR) to consider whether $100 billion in additional tariffs would be appropriate under section 301.** Following an investigation announced in February, China's Ministry of Commerce announced it would start imposing preliminary anti-dumping duties on imports of sorghum to China, almost all of which comes from the United States. Starting April 18, sorghum importers are required to put down a 178.6% deposit in anticipation of these tariffs.

Meanwhile, in an apparent attempt to send the Trump Administration positive signals, **China** reiterated previously-made commitments and **announced accelerated timelines for elimination of equity caps for foreign investment in joint ventures**, ranging from banks and insurance firms to autos, ships, and aircraft manufacturing.

Even so, USTR is working now to identify $100 billion worth of Chinese exports to the U.S. that would be covered by increased tariffs. We expect this list to be made public in the near future. USTR is also reportedly considering a new complaint under Section 301 regarding unfair restrictions of U.S. cloud computing and high-tech services in China. **In addition to applying tariffs, the U.S. is pursuing Chinese investment restrictions and a WTO case on Chinese IP and licensing practices on a parallel path**, with the EU, Japan, Taiwan, Ukraine, and Saudi Arabia already asserting third party rights.

Comment: The **extent of the fallout from 301 is not yet clear**, as much depends on success criteria for each side.

- **If a "win" is a narrowing of the trade deficit and auto market access, the Chinese could deliver an outcome before tariffs are implemented,** and avert a

downward spiral. However, we do not think the Trump Administration would accept this outcome.

- In another scenario, the two sides agree to accelerate guidelines for removal of equity caps in financial, auto, and other sectors, paired perhaps with Chinese purchase of high-value LNG or other large, one-time purchases to temporarily reduce the U.S. trade deficit with China. This would generate headlines but do nothing to resolve the long-term problems regarding Chinese intellectual property practices.
- **If the goal of the U.S. is to dismantle China's industrial policy** (as we believe to be the case), **we are headed toward mutual imposition of tariffs**. China's Made in 2025 policies, built to foster industries it deems critical to national security, are not on the trade negotiating table, and the Trump Administration has not yet defined interim steps that the Chinese could take to address its policy concerns.

IEEPA

The 1977 **IEEPA** (International Emergency Economic Powers Act) **allows the president to declare a national emergency in order to unilaterally block investments or transactions that would harm "national security, foreign policy, or economy of the United States.**" In April 2018 Trump directed the Treasury Department to look into using the IEEPA to enact parts of the proposed CFIUS reform bill (FIRRMA) as part of the U.S. government response to 301. Treasury **Secretary Mnuchin has until May 21 to propose executive action on FIRRMA** under IEEPA.

Comment: A Chinese Foreign Ministry spokesman forcefully cited protectionism, rather than national security, as the real motive for the potential IEEPA action. However, **without a formal investment restriction from the administration, forceful comments are the strongest reaction we will see out of Beijing.** Unofficially, we have already seen less enthusiasm for Chinese investment in the United States. The most recent example was Huawei last week announcing it would concentrate on existing markets, rather than continue to pursue expansion in the United States.

CFIUS and ECRA

The **CFIUS reform bill** (Foreign Investment Risk Review Modernization Act, FIRRMA) **and the Export Control Reform Act** of 2018 (ECRA) **are Congressional actions intended to tighten foreign investment and export restrictions**, particularly for high-tech products and services.

If passed, FIRRMA would extend CFIUS review timeframes, increase the scope of transactions subject to CFIUS's jurisdiction, make certain notifications mandatory, and establish a process for expedited review and approval of certain transactions. ECRA would modernize U.S. export control regulation of commercial and dual-use items. By design, U.S. export controls work in harmony with CFIUS.

Comment: Introducing the ECRA, Chairman Royce emphasized that **the need for export control reform is driven by aggressive Chinese government policies that**

force U.S. companies to hand over sensitive technology as a cost of doing business in China. In response, the ECRA establishes a framework to protect critical and emerging U.S. technology and know-how, an issue also taken up through FIRRMA. The ECRA passed the House Foreign Affairs Committee on April 17, and FIRRMA should pass the House Banking Committee in the near future, but the final form for both pieces of legislation remains unclear. The latest from Sen. Cornyn this week points to the possibility of including both FIRRMA and ECRA in the upcoming update of the National Defense Authorization Act. Regardless of the vehicle, **both sides of the aisle agree that increased scrutiny as mandated in FIRRMA and ECRA is critical, and these reforms will almost certainly be passed in some fashion.**

Investment Scrutiny

Killed or Abandoned Under Trump: Committee on Foreign Investments in the U.S. steps up opposition to takeovers from abroad (Bloomberg)

Target	*Would-be Acquirer*	*Country*	*When Killed*	*Deal Size*
Qualcomm	Broadcom	Singapore	Mar 2018	$117 billion
Xcerra	Hubei Xinyan Equity Investment	China	Feb 2018	$580 million
MoneyGram	AntFinancial Services Group	China	Jan 2018	$1.2 billion
Cowen	China Energy Company Ltd	China	Nov 2017	$100 million
Aleris	Zhongwang USA	China	Nov 2017	$1.1 billion
HERE	NavInfo	China	Sep 2017	$330 million
Lattice Semiconductor	Canyon Bridge	China	Sep 2017	$1.3 billion
Global Eagle Entertainment	HNA Group	China	Jul 2017	$416 million
Novatel Wireless	TCL Industries	China	Jun 2017	$50 million