

Resolving the China Trade War: Will Any Resulting Agreement Be Both Meaningful and Enforceable?

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04 / 23 / 19

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The recent sluggishness of the Chinese economy and tariffs imposed by the U.S. government on Chinese-origin imports have created favorable conditions for negotiations between the two governments. The dialogue is aimed at resolving long-standing differences with respect to issues like intellectual property protection, forced technology transfers, cybertheft, currency manipulation, Chinese industrial policies and the bilateral trade imbalance with respect to goods. As a result, it appears that some form of agreement is imminent, but significant questions remain regarding whether the actions already taken and the commitments to be made by the government of China will substantively address these issues and, perhaps more importantly, be readily enforceable. Absent effective enforcement, there is considerable risk that the Chinese will renege on their commitments altogether or otherwise dilute the benefits afforded to U.S. exporters and investors.

Section 301 Tariff Actions. Pursuant to Section 301 of the Trade Act of 1974 and in response to Chinese-forced technology transfer requirements, the cybertheft of U.S. trade secrets, discriminatory Chinese licensing policies and attempts to acquire sensitive U.S. technology to advance Chinese industrial policy, the U.S. government has imposed tariffs since July 2018 on approximately \$250 billion of Chinese-origin imports. The tariffs have been levied in three tranches. The first tranche targeted approximately \$34 billion of Chinese-origin imports with 25 percent tariffs and took effect on July 6, 2018. The second tranche targeted approximately \$16 billion of Chinese-origin imports with 25 percent tariffs and took effect on August 23, 2018. The third tranche, which took effect on September 24, 2018, targeted approximately \$200 billion of Chinese-origin imports with 10 percent tariffs. Those 10 percent tariffs initially were scheduled to escalate to 25 percent on January 1, 2019, a deadline that subsequently was extended until March 1, 2019. In late February 2019, the escalation date was extended indefinitely in light of the progress being made during negotiations.

The Chinese government has responded in kind with 25 percent tariffs on approximately \$50 billion of U.S.-origin imports and 5-10 percent tariffs on an additional approximately \$60 billion of U.S.-origin imports.

The Office of the U.S. Trade Representative (USTR) has established a mechanism for the submission of product exclusion requests for those items caught by the first and second tranches or tariffs, but no such mechanism has yet been established for those items caught by the third tranche of tariffs. USTR has stated that there will be no product exclusion process established for these items unless and until the tariffs are escalated to 25 percent.

Key Chinese Actions and Commitments. As an initial step toward addressing U.S. concerns pertaining, in particular, to forced technology transfers, on March 15, 2019, the Chinese government passed a new foreign investment law that is slated to take effect on January 1, 2020. Under the new law, forced technology transfers will be prohibited, and Chinese government officials conducting regulatory reviews and the like will be forbidden from divulging confidential corporate information to Chinese competitors. Violators could be criminally prosecuted. In addition, the law will eliminate the requirement that foreign investors find local partners to enter the Chinese market. On its face the law appears to be a positive development, but U.S. companies that routinely conduct business in China worry that its lack of detail will result in regulatory implementation — particularly at the local level — that continues to disadvantage foreign firms.

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Though details are scant, the Chinese government also reportedly has agreed not to competitively devalue its currency and to increase transparency by reporting any interventions into its market. In addition, according to news reports the Chinese government has committed to de-emphasizing the “Made in China 2025” program by significantly reducing market-distorting subsidies to entities operating in the targeted industries.

Finally, to alleviate the U.S. trade deficit, the Chinese government reportedly has agreed to substantially increase its purchases of U.S. goods, totaling approximately \$1.2 trillion over six years, an increase of approximately 30 percent annually. Some commenters have suggested that such a move may be in violation of World Trade Organization commitments. Among the most notable products under consideration are U.S. farm goods, such as soybeans and meats, natural gas (specifically, an \$18 billion dollar purchase from Cheniere Energy, Inc.), semiconductors, and Boeing aircraft.

In the case of semiconductors, the Chinese government apparently has offered to purchase \$30 billion of U.S. chips over six years (down from an initial offer of \$200 billion). However, the U.S. semiconductor industry has pushed back, arguing that mandatory purchases likely would drive U.S. companies to establish production facilities in China given the comparable higher cost of production in the United States. Such a shift would risk giving the Chinese greater control over the U.S. semiconductor industry, a critical component of U.S. national security. And in the case of Boeing aircraft, recent safety-related incidents have dampened Chinese enthusiasm for the aircraft.

Verification and Enforcement. In late February 2019, U.S. Trade Representative Robert E. Lighthizer testified before the House Ways & Means Committee that the agreement would include a hierarchical framework for dialogue to resolve disputes, but that the United States would reserve the right to take unilateral

and proportionate action at any time to enforce the agreement. While this may yet be the case, it is becoming less likely that the United States will lift all of the tariffs on Chinese-origin imports upon signing. Rather, it is now understood that while certain tariffs may be lifted, others will remain in place to leverage compliance. This issue very well could become a significant enough sticking point that the agreement in its entirety could be endangered. Indeed, the Chinese government already reportedly has retrenched certain of its positions regarding intellectual property protection, including those relating to pharmaceuticals for example. Another possible tariff-related issue likely to cause friction is whether the Chinese government will agree not to retaliate against any action taken by the United States to “snap back” tariffs in the event of a compliance failure.

Status of Ongoing Negotiations. Negotiations over a reportedly 150-page agreement are ongoing. Lighthizer and Treasury Secretary Steven Mnuchin traveled to Beijing in late March 2019 and their Chinese counterpart, Vice Premier Liu He, is expected to travel to the United States in April 2019, perhaps with an eye toward a late April signing ceremony. However, late April seems overly optimistic, particularly in light of recent statements from senior administration officials suggesting that the negotiations are not time-dependent and could take several more months. Lighthizer testified publicly at the House committee hearing that the agreement is being negotiated under the auspices of Section 301 of the Trade Act and, therefore, constitutes an executive agreement that does not require submission to Congress, eliminating any delay that ordinarily would be associated with congressional review.

Though an agreement is not assured, both parties appear to have an incentive to come to terms. Whether those terms meaningfully will address the systemic concerns expressed by the United States and will be effectively enforced remains to be seen.