

# 18-17 How the United States Should Confront China Without Threatening the Global Trading System

**Robert Z. Lawrence**  
August 2018

**Robert Z. Lawrence**, nonresident senior fellow at the Peterson Institute for International Economics, is the Albert L. Williams Professor of Trade and Investment at the John F. Kennedy School of Government at Harvard University. He thanks C. Fred Bergsten, Olivier Blanchard, Jérémie Cohen-Setton, Jeffrey Frankel, Annabel Gonzalez, Gonzalo Huertas, Ted Moran, Yeling Tan, and Steve Weisman for their comments and Madona Devasahayam for superb editorial assistance.

© Peterson Institute for International Economics.  
All rights reserved.

President Donald Trump has been escalating the administration's economic confrontations with China, the European Union, and other trading partners over most of the last year. Each battle has employed a particular legal rationale, including the invocation of national security, and claims about burdening US commerce to impose—or threaten to impose—tariffs and/or quotas on imports. Many of these steps have been notable for violating rules and regulations embodied by previous agreements with trading partners or by those enforced by the World Trade Organization (WTO). President Trump's actions and threats have nearly always provoked trading partners to retaliate and warn of further actions, posing a major risk to worldwide flows of goods, services, and investments.

This Policy Brief argues that the Trump administration's willingness to violate trade rules to maximize its negotiating leverage is undermining its most important and most legitimate objective in international trade and investment: persuading China to reform its problematic economic

system, in which foreign firms are discriminated against in high-tech projects. This discrimination by China is aimed at fostering its industrial development. Foreign firms have cited multiple instances of Chinese pressures to transfer technology in exchange for market access. There is also widespread concern in the United States about China subsidizing Chinese companies that acquire foreign firms with leading edge technologies while preventing similar acquisitions in China. But the administration's actions, coupled with China's retaliations, have so far been counterproductive. And overall they have weakened adherence to rules and norms that have contributed to the success of the global trading and investment system. The economic costs are in danger of being compounded by a loss of confidence in open markets due to the failure to enforce trade rules.<sup>1</sup>

Persuading China to reform by showing they are breaking the rules of a system in which they have an interest will be far more effective than trying to bully them to take actions that they see as preventing their development. The problems presented by China's own protectionist policies and weak enforcement of intellectual property rights could have been dealt with through measures that would have been consistent with the role of the United States as the leader of the rules-based trading system rather than its greatest threat. Instead of alienating its allies by using the pretext of national security to impose tariffs on their steel and aluminum exports (and further threatening to impose tariffs on their automotive exports), as outlined by Jennifer Hillman,<sup>2</sup> the United States should have joined with its allies to put pressure on China to conform to WTO rules where these are applicable. It could also take steps outside the WTO to induce China to make its market more open to foreign investment and to impose new disciplines on the behavior of state-owned enterprises.

The argument presented in this Policy Brief is based on something that the administration seems to have forgotten: that even though the United States is still the world's largest

---

1. For evidence on the importance of policy certainty on trade and investment decisions, see Crowley and Ciuriak (2018) and Pierce and Schott (2016).

2. Jennifer Hillman, "The Best Way to Address China's Unfair Policies and Practices Is Through a Big, Bold Multilateral Case at the WTO," testimony at Hearing on US Tools to Address Chinese Market Distortions, US-China Economic and Review Security Commission, June 8, 2018.

economy, it is only one country in the system. Most countries around the world continue to see that system as in their interest. Although there is a danger of countries losing faith in the rules-based economic system, US actions may have an opposite and beneficial effect if it encourages major economic players in the world to increase their efforts to sustain and build an even stronger rules-based system that achieves deeper integration.

## **The Trump administration's willingness to violate trade rules to maximize its negotiating leverage is undermining its most important and most legitimate objective in international trade and investment: persuading China to reform its problematic economic system....**

As a separate matter, President Trump may also find that his trade approach is having negative effects on US economic interests at home as well as abroad. While many Americans agree with the administration's concerns about current Chinese practices with respect to technology transfers and intellectual property theft, there is considerable domestic opposition to the administration's policies to counter these practices. Specifically, many American firms and farmers are worried that Trump's policies and retaliations to them are disrupting their supply chains at home and cutting off their access to markets abroad. Similarly, Trump's protectionist measures will raise input costs, costing jobs in the United States. In addition, he has spurred other countries to conclude agreements that discriminate against US exports. For example, the countries that signed on to the Trans-Pacific Partnership (TPP)—the Obama era trade agreement that President Trump canceled when he took office—have agreed to proceed with the accord without American participation, to the likely detriment of American exporters. He also spurred the European Union and Japan to conclude their free trade agreement.

### **NOT PLAYING BY THE RULES: WHAT TRUMP AND CHINA HAVE IN COMMON**

The global trading system has enhanced the living standards of billions of people. One of the primary means has been through production based on global value chains (Baldwin 2016) International trade no longer consists of goods and services produced mainly in one country and sold in another. Instead, countries specialize in tasks rather than products and final goods are assembled using intermediate components

and services that originate from many countries—in short, goods and services are now “made in the world.”<sup>3</sup> But this trading system depends entirely on governments complying with agreed rules that set the conditions for market access and nondiscriminatory treatment of foreign goods, services, and firms.<sup>4</sup>

President Trump rejects the basic propositions accepted by almost all economists that exports and imports are both beneficial and that the trade balance is basically determined by macroeconomic forces such as saving and investment rather than trade policies, whether fair or unfair.<sup>5</sup> Instead, Trump views exports as good, imports as bad, and the trade balance as the measure of whether trade is beneficial and trade policies are successful.

Trump has also many times asserted that foreign production by US firms generally comes at the expense of their domestic production and that US firms that produce goods offshore must be punished. His policies threaten the global value chains that have made production more efficient and helped deliver prosperity throughout the world while lowering prices for consumers. He has disdained prior trade agreements and sought to abrogate or renegotiate them, using tariffs or threats as a negotiating tool, even if these tariffs violate US commitments and are based on pretexts that would not stand international legal scrutiny.

On the other hand, Chinese trade barriers in many industries remain high by industrial-country standards. China has also closed several key sectors to foreign investment and limited foreign investment in others to joint ventures with minority ownership. Facebook and Google are banned from China, and foreign companies cannot bid for government information technology contracts. China has also at times favored domestic firms with subsidies and tried to give only domestic producers access to rare earths by banning their export. The Chinese state and leadership also play an unusually large role both directly, through owning many large companies, and indirectly, through the influence and power of the Communist Party (Wu 2016).

China defends these policies on the ground that it should be given “special and differential treatment” and is entitled to use higher tariffs and more investment restrictions than advanced economies because it is a developing country. In addition, China proclaims that as a “socialist market

3. See the OECD's Trade in Value Added (TiVA) database at [www.oecd.org](http://www.oecd.org).

4. For example, Pierce and Schott (2016) argue that China's entry into the WTO enhanced confidence that its products would be given most favored nation treatment and had a powerful impact on encouraging firms to produce products for the export market in China.

5. For a more detailed exposition of the flaws in Trump's views of trade balances, see Lawrence (2018).

economy,” it must allow market forces to interact with the actions of government, state-owned companies, and state-owned banks.

China’s earlier specialization in mainly labor-intensive products and assembly meant that there was little overlap between Chinese and US exports (Edwards and Lawrence 2013). But China’s more recent industrial policies aim at enhancing its competitiveness in the high-technology industries, in which advanced economies specialize. China is now using state-centered industrial policies and state-owned enterprises to encourage indigenous innovation and increase the market share of domestic firms in industrial activities such as robotics, autonomous vehicles, pharmaceuticals, artificial intelligence, semiconductors, and biomedicine. China’s ambitious programs are part of its Made in China 2025 plan, which is aimed at making China more self-sufficient in these areas.<sup>6</sup>

Chinese government officials claim that these programs are consistent with its international obligations and that China does not generally discriminate against foreign firms and in return should be given free access to foreign markets and technologies. But foreign firms that operate in China increasingly complain that China is not playing by the rules.<sup>7</sup> These claims are documented in reports by the US government (USTR 2017), the US Chamber of Commerce (2017) as well as the European Union Chamber of Commerce in China (2017), citing cases in which foreign firms have trouble obtaining operating permits and are discriminated against in regulatory treatment unless they transfer their technologies to Chinese partners.<sup>8</sup>

## HOW RECENT US TRADE MEASURES UNDERMINE THE RULES-BASED TRADING SYSTEM

**Section 232.** The Trump administration invoked national security as the reason to impose tariffs of 25 percent on US steel imports and 10 percent on imports of aluminum, citing Section 232 of the Trade Expansion Act of 1962. This US law places almost no constraints on the president’s ability

6. Keith Bradsher and Paul Mozur, “China’s Plan to Build Its Own High-Tech Industries Worries Western Businesses,” *New York Times*, March 7, 2017, [www.nytimes.com/2017/03/07/business/china-trade-manufacturing-europe.html?\\_r=0](http://www.nytimes.com/2017/03/07/business/china-trade-manufacturing-europe.html?_r=0).

7. For a more complete explication of the problems presented for the WTO by the Chinese system, see Wu (2016).

8. There are also growing national security concerns in the United States. Several technologies being developed in Made in China 2015 have military as well as civilian uses and the Chinese military has in the past been guilty of helping steal US technologies and trade secrets. Products of Huawei Corporation are now avoided because of fears they could be used to hack US telecommunications, and the firm ZTE has been found guilty of repeatedly violating US trade sanctions on countries like Iran and North Korea.

to apply this law and Article XXI of the General Agreement on Tariffs and Trade (GATT), which took effect in 1948, gives countries great scope in deciding *for themselves* whether such measures are warranted. This makes it difficult for such actions to be challenged either domestically in the United States or internationally through dispute settlement. In principle, the Trump measures are legal under GATT but in practice, precisely because of the great latitude afforded by this provision, it has always been understood that members will rarely undertake such measures, and only for narrowly defined reasons relating to strictly military needs and extreme circumstances. But the Trump administration ignored this longstanding tradition and adopted an excessively broad definition of national security.

Belying its national security motivations, the administration’s invocation of national security has used the tariffs as a bargaining chip for a variety of purposes. Initially, it temporarily exempted Mexico and Canada from the tariffs in order to use the threat of tariffs to extract concessions in the renegotiation of the North American Free Trade Agreement (NAFTA). However, when concessions were not forthcoming, it included them among the countries that were subject to national security–driven levies. The administration has felt free to double the tariffs levied against Turkey in an effort to force it to release an individual the Turks accused of spying, and it has shown special favor to Australia by totally exempting it from tariffs or quotas.

In the case of South Korea, the administration used tariff threats to impose a quota limiting Korea’s steel exports to the United States to 70 percent of the average of its exports to the United States between 2015 and 2017. This quota represents a new “voluntary restraint agreement”—an approach outlawed in the Uruguay Round trade agreement of 1994. Similar steel quota arrangements have been reached with Brazil and Argentina.

Several countries have retaliated, contending that these US Section 232 measures are actually “safeguards” covered by other trade laws enforced by the WTO. Other WTO members have claimed that the US measures “nullify and impair” concessions to which these members are entitled.<sup>9</sup> The administration has rejected these objections and

9. Mexico and India have also claimed that the US action is a nonviolation nullification and impairment under GATT Article XXIII:1(b) (see “Non-Violation Claims in the Steel/Aluminum WTO Complaints,” International Economic Law and Policy Blog, <http://worldtradelaw.typepad.com/ielpblog/2018/06/the-steelaluminum-wto-complaints.html>). The United States has initiated WTO dispute settlement proceedings with Canada, Mexico, the European Union, Turkey, and China over tariffs the countries have placed on US products in response to steel and aluminum duties. The United States claims that the retaliatory duties put in place by the five countries with which the United States has

launched WTO cases against the countries that have made them.

Thus, in just one action, several WTO rules and practices have been undermined. First, the United States has provided such a liberal interpretation of national security that if the precedent is set, the national security exception could be used to undermine the value of market access concessions in almost any product. What is to stop a country from arguing that it is necessary in its national defense interest to protect its footwear industry since its army needs boots

## The selective nature of these supposed national security actions violates the most favored nation principle of the multilateral system....

when it marches or to protect its tuna industry since its army eats fish?<sup>10</sup> Russia is poised to emulate the US approach with respect to products from the Ukraine. The Trump administration has also launched a Section 232 investigation in May 2018 to determine the national security effects of imports of automobiles (including cars, SUVs, vans, light trucks, and automotive parts).<sup>11</sup>

The selective nature of these supposed national security actions violates the most favored nation (MFN) principle of the multilateral system, which ensures equal rather than exclusive trading privileges between two partners.

**Section 301.** The most substantial action taken by the administration has been brought under Section 301 of the US Trade Act of 1974 against China. The United States has found that Chinese innovation policies are “unreasonable or discriminatory” and “burden or restrict U.S. commerce.” The administration has four major complaints. The first is that China has been depriving US firms of the ability to be paid on market terms for their technologies. Part of this

claim is that China has imposed different requirements on foreign and domestic firms, for example, requiring foreign but not domestic firms to give up their claims on intellectual property after ten years. The second complaint is over the alleged use of foreign ownership restrictions such as opaque and discretionary administrative approvals and other requirements for joint ventures to pressure the transfer of technologies and intellectual property to Chinese companies. The third is that the Chinese government has been facilitating the acquisition by Chinese firms of US companies to obtain strategically important technologies, and the fourth is that the Chinese government has encouraged illegal intrusions into US computer networks to steal intellectual property and trade secrets.

After several rounds of failed negotiations, on June 15, 2018, the administration announced that tariffs of 25 percent would be imposed on Chinese exports valued at \$46.3 billion in two stages. The first round of tariffs of 25 percent on imports worth \$34 billion went into effect on July 6. China responded by announcing its intention to impose tariffs on US products of equivalent value. Angered by this response, President Trump called for tariffs on an additional \$200 billion worth of Chinese exports. On July 10, the administration published a list of these products for public comment after which these additional tariffs would be imposed.

Chinese officials claim that Chinese policy enforces intellectual property rights and provides equal treatment to foreign investment in general.<sup>12</sup> When President Obama showed evidence that the Chinese government was assisting in the illegal activity of stealing trade secrets, President Xi Jinping reportedly ordered the government to stop the practice.<sup>13</sup> In other words, the Chinese government officially acknowledges that it is wrong to fail to enforce the intellectual property rights of foreign firms; wrong to require technology transfer as a condition for investment; and wrong to encourage cyber espionage on foreign corporations. A major

---

requested consultations “are completely without justification under international rules.” See “U.S. initiates WTO disputes over retaliation to Section 232 tariffs,” *Inside US Trade*, July 19, 2018, <https://insidetrade.com/inside-us-trade/us-initiates-wto-disputes-over-retaliation-section-232-tariffs>.

10. Sweden temporarily used Article XXI between 1975 and 1977 to protect its footwear industry with a quota (Macroy, Appleton, and Plummer 2005).

11. According to the European Union, an auto tariff would affect six times as much trade as the measures on steel and aluminum and up to \$294 billion worth of US exports (an amount equal to 19 percent of all US exports in 2017) could be subject to countermeasures. See “EU: Auto tariffs will invite retaliation on nearly \$300 billion of U.S. goods,” *Inside US Trade*, July 3, 2018, <https://insidetrade.com/daily-news/eu-auto-tariffs-will-invite-retaliation-nearly-300-billion-us-goods>.

---

12. At the World Economic Forum in Davos and at the State Council in January 2017, President Xi Jinping made commitments to encourage investment in advanced manufacturing by foreign-invested enterprises and to ensure that these companies receive equal treatment under strategic policies and measures related to Made in China 2025.

13. The United States and China reached an agreement in 2015 to curb cyber-enabled theft of intellectual property and committed to common efforts to promote norms of state behavior in cyberspace (see White House, “Fact Sheet: U.S.-China Economic Relations,” September 25, 2015, <https://obamawhitehouse.archives.gov/the-press-office/2015/09/25/fact-sheet-us-china-economic-relations>). Partly due to the agreement, the cyberattacks appear to have diminished. See “Chinese Curb Cyber Attacks on US Interests,” *New York Times*, June 21, 2016, [www.nytimes.com/2016/06/21/us/politics/china-us-cyber-spying.html](http://www.nytimes.com/2016/06/21/us/politics/china-us-cyber-spying.html).

point of disagreement is whether the Chinese government is responsible for the market behavior of its firms.

For the Chinese the key question is whether an agreement between a foreign company and a Chinese company on technology transfer is a voluntary market-based transaction or unwarranted government intervention. While the Chinese argue that whatever the parties negotiate should be accepted as legitimate, in a genuinely free market, the foreign firm

## **There is no need for Washington to impose tariffs on Chinese imports for any of its Section 301 complaints.... All the US concerns could have been dealt with in other ways that do not violate WTO rules.**

would have the choice of (1) exporting the product to China, (2) setting up its own operation and producing in China, or (3) engaging in a joint venture. If all three options were available, it would indeed be unreasonable to challenge such an arrangement. But if the options of exporting to China and investing in a fully owned subsidiary are excluded by the government, then market entry *can* be used as leverage over the foreign firm to transfer its technology if it wishes to participate in the Chinese market and be viewed as an unfair practice by foreign firms. The ultimate solution to this problem would not be to try to discipline the terms of negotiations over technology rights but rather to allow market forces to work more fully by demanding that China open the Chinese market to imports and foreign investment so that negotiations over technology rights with joint ventures would be conducted by foreign participants who would have the full range of options to use their technologies. Much of this could be done by completing the bilateral investment treaty that the Obama administration was negotiating.

A second crucial set of questions can be raised about the administration's methods. In particular, it has tried to gain leverage by using tariffs rather than by invoking WTO rules. In fact, tariffs are not needed for its first complaint because the administration *can* and is exploiting the WTO rules in the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which forbids discrimination in the application of intellectual property protection. The United States Trade Representative (USTR) has, moreover, noted in its Section 301 document that China agreed in its accession protocol to the WTO in 2001 that the rights of foreign investors would not be conditioned on performance requirements such as local content, transfer of technology,

or conduct of research and development in China.<sup>14</sup> In effect, the administration is acknowledging that the WTO dispute settlement system could also be used on the second complaint, which relates to forced technology transfer. Thus, rather than imposing tariffs, the United States should have joined the European Union and Japan and brought another case against China on this issue. Because WTO rules do not cover foreign investment, the United States also has better tools than tariffs that it can use to pressure China on its unfair investment practices. It can, for example, unilaterally prohibit China from buying US technology through the acquisition of US companies, invoking the powers of the Committee on Foreign Investment in the United States (CFIUS), an interagency group administered by the US Treasury, which is being given more powers to limit foreign investment in the United States that jeopardizes national security.<sup>15</sup> In particular, together with the European Union and Japan, a tit-for-tat approach should be used, in which Chinese firms are not allowed to invest abroad in sectors where the Chinese market is closed to foreign investment.

Thus there is no need for Washington to impose tariffs on Chinese imports for any of its Section 301 complaints. The use of tariffs, which are illegal because they violate US commitments to grant China permanent normal trade relations and because they exceed the maximum rates the United States is allowed to impose under WTO rules, is unnecessary. All the US concerns could have been dealt with in other ways that do not violate WTO rules.

## **DOES PRESIDENT TRUMP WANT AN AGREEMENT OR A TRADE WAR?**

When President Trump initiated his trade war actions, many political analysts contended that they would not lead to trade warfare but rather to a negotiation, followed by pragmatic responses in which China would reduce its bilateral trade surplus by buying more aircraft, agricultural products like soybeans, and other US exports. Had China done so in combination with additional market opening (in finance, autos, and other sectors) and increased domestic enforcement

14. Section 7(3) of the Protocol on the Accession of the People's Republic of China states that "China shall ensure that...the right of investment by national and sub-national authorities is not conditioned on: whether domestic suppliers of such products exist; or performance requirements of any kind, such as local content, transfer of technology, export performance, or the conduct of research and development in China" (attributed to Julia Qin and quoted by Simon Lester at <http://worldtradelaw.typepad.com>). See also USTR (2017, 19).

15. Senator John Cornyn has proposed a bill that would reform CFIUS to ensure that Chinese companies receive reciprocal treatment when looking to invest in the United States.

efforts to protect intellectual property and end discriminatory actions against foreign firms, President Trump could have claimed victory, though at the cost of engaging in managed trade in violation of WTO rules.

Ironically, if China made such concessions, especially opening up its markets and protecting US intellectual property, China would become a *more attractive* location for foreign investment. This would conflict with the US approach in the NAFTA negotiations, which is aimed at making offshoring to Mexico *less attractive* by weakening the investor-state dispute settlement provisions, increasing local content requirements, and requiring a sunset provision in which, unless renegotiated, the agreement would expire after five years.

But China is unlikely to be swayed by potential economic losses if its national interests, if not its dignity, is threatened. The Made in China 2025 program, for example, is the lynchpin of President Xi Jinping's development strategy.

It may be that President Trump, knowing that these demands will not be met, actually prefers to impose tariffs over negotiating a deal with China, because he believes that protectionism will shield American workers from the global economy.

In fact, a large share of the first-round tariffs planned by the administration was imposed on products made in China and exported to the United States by foreign rather than Chinese firms. This is not coincidental. China has specialized in assembling final products using inputs from other countries. As it seeks to become a more developed country, the Made in China 2025 program aims to increase the Chinese content in these products (Lovely and Liang 2018).<sup>16</sup> Imposing tariffs on such products would be consistent with President Trump's effort to discourage offshoring in other countries like Mexico.

## IMPACT OF TARIFFS

Most analyses by economists conclude that the tariffs imposed in the exchanges between the United States and its trading partners are unlikely to do large macroeconomic

damage in the short run.<sup>17,18</sup> But the complexities of global value chains make it plausible to predict more major effects, even though some market participants in the United States and China could find it easy to work around the obstacles posed by these conflicts.

The effective impact on Chinese production could be higher than suggested by the nominal value of the tariff rates, because of the involvement of foreign firms. For example, if a machine imported from China has 25 percent of its value produced in China and 75 percent of its value imported duty-free from Korea, the imposition of a 25 percent tariff on the machine would represent a tax equivalent to 100 percent of the Chinese value. In other words, China would become twice as expensive a location for assembly, and these operations could be forced to relocate entirely. But if the assembled machines could easily be shipped back to Korea and then exported to the United States as Korean products, the effects on China might be minimal. These factors make it difficult to predict how detrimental the effects on global supply chains will turn out to be.

But whatever their impact on existing global value chains, the more significant impact of the current actions and the retaliations they have sparked will be felt over the longer run in destroying the confidence of the firms that operate these chains that they can continue to rely on stable conditions for market access. In the short run, given the increased uncertainty, they are likely to delay their investment plans and over the long run become less reliant on global supplies.

## FOREIGN AND DOMESTIC RESPONSES TO TARIFFS

How the rest of the world reacts to US tariffs will also determine the extent of the damage to the global economy. Countries seeking to retaliate should use the WTO process to do so. The United States is blocking appointments to the WTO Appellate Body, undermining the dispute settlement process, while refusing to make clear what must be done for new appointments to go forward. But these tactics need not bring dispute settlement to a halt. As the former chairman of the Appellate Body James Bachus (2018) has advocated, the other WTO members should use arbitration under Article

16. According to Lovely and Liang (PIIE Chart at <https://piie.com/research/piie-charts/revised-tariffs-against-china-hit-non-chinese-supply-chains-even-harder>), fully 87 percent of US imports from China in computer and electronic products come from non-Chinese multinational firms. Similarly, they report that the share of US imports from China of transportation equipment, electrical equipment, and nonelectrical machinery are typically over 60 percent.

17. A tariff of 25 percent on US imports of \$50 billion plus tariffs of 10 percent on imports of \$200 billion together raise import costs by \$32.5 billion. This remains very small compared with US GDP of \$20 trillion a year. Nonetheless, as shown by Noland, Robinson, and Moran (2016), a larger trade war with higher tariffs, more comprehensive coverage, and retaliation by China and Mexico could lead to large US job losses.

18. See Citibank, *Global Economics View*, July 11, 2018. For estimates of the impacts of the tariff war, see also Freund et al. (2018).

25 of the WTO dispute settlement system until the Appellate Body positions can be filled.

Even without the United States, other countries could bring cases at the WTO aimed at addressing Chinese trade practices. In addition, they could go ahead with additional deeper regional agreements among themselves that improve on WTO rules on issues such as subsidies and state-owned enterprises. The precedent for this approach lies in the decision of the other TPP countries to go ahead with their agreement (renamed the Comprehensive and Progressive Agreement for the Trans-Pacific Partnership, or CPTPP) despite the US boycott. The CPTPP could also be expanded to include other countries, including those in the Regional and Comprehensive Economic Partnership (RCEP).

### **Instead of confronting China with unilateral actions, the administration should be working with its allies to put pressure on China to conform to WTO rules where these are applicable.**

China's various actions supporting its economic nationalism make it increasingly implausible to claim that it should be treated like other developing countries and granted leeway from the application of WTO rules. China is the world's largest trading nation and often its largest producer, as evidenced by the global gluts created by the explosion in China's productive capacity in industries like steel, aluminum, cement, and solar panels.<sup>19</sup> Chinese domestic policies, therefore, have significant international implications. Moreover, China's efforts to acquire foreign firms and technologies is increasingly seen as incompatible with its restraints on foreign firms pressing for access to the world's largest single market. China's industrial policies are now focused on competing with other industrial countries. It would therefore be wrong to treat China like any other developing country. It is too big and potentially competitive to continue limiting participation by foreigners in a more open market. It should set the example because as

19. Matt Schivenza quotes a study showing that in 2011 China accounted for 90.6 percent of world production capacity for personal computers, 80 percent of energy saving lamps, 74 percent of solar cell production, 70.6 percent of mobile phones, 63 percent of shoes, 60 percent of cement, 48.2 percent of coal, 45.1 percent of shipbuilding, and 49.8 percent of pork. See Matt Schivenza, "China's Dominance in Manufacturing in One Chart," *The Atlantic*, August 2013, [www.theatlantic.com/china/archive/2013/08/chinas-dominance-in-manufacturing-in-one-chart/278366](http://www.theatlantic.com/china/archive/2013/08/chinas-dominance-in-manufacturing-in-one-chart/278366).

the world's largest trading nation China has a great interest in a system based on rules.

But the door is wide open for China to assume global leadership by liberalizing its economy, opening more sectors to majority-owned foreign investment, enhancing its protection of intellectual property rights, especially for foreign nationals, and permitting foreign firms based in China to participate more fully in its industrial policies. These actions are in China's long-run interest, and China needs to supplement its official rules by imparting nondiscrimination directives to government officials and its firms so that discriminatory behavior is no longer the norm. China's earlier global engagement in the 1980s, 1990s, and early 2000s was made possible because of the support of foreign companies that benefited from assembly operations in China and sales in the Chinese markets. A home market that is open to trade and reciprocal investment is vital for sustaining China's global engagement in the future.

Rectifying the damage caused by the US administration's actions will require changes in US policies. Without such changes, the United States will find itself increasingly isolated and its exports—both manufacturing and agriculture—discriminated against by agreements in which it does not participate and less competitive in a world in which steel, aluminum, and other products made by other countries are not subject to tariffs. To avoid such a prospect, Congress could reassert its prerogatives by limiting presidential discretion in citing national security as justification for its trade wars. Article 1, Section 8 of the US Constitution gives the Congress rather than the president the right to "regulate Commerce with foreign nations." The War Powers Act enacted in 1973 limits how long the president can keep troops at war without congressional approval. Surely, similar rules should apply to a trade war—especially one waged in the name of economic security.<sup>20</sup>

In conclusion, the Trump administration could have dealt with the problems posed by China through measures that would have been consistent with preserving the rules-

20. In 1996, Congress gave President Bill Clinton the power to veto line items in the budget, but in 1998 the Supreme Court ruled the practice unconstitutional on the grounds that Congress could not delegate its constitutional duty to legislate. The American Institute for International Steel has filed a complaint arguing, along similar lines, that Section 232 of the Trade Expansion Act of 1962 "constitutes an improper delegation of legislative authority to the President, in violation of Article I, section 1 of the Constitution and the doctrine of separation of powers and the system of checks and balances that the Constitution protects" (see "Steel group seeks summary judgment at CIT in Section 232 tariff case," *Inside US Trade*, July 23, 2018, <https://insidetrade.com/daily-news/steel-group-seeks-summary-judgment-cit-section-232-tariff-case>). The trial is currently proceeding.

based trading system rather than threatening it with destruction. Instead of confronting China with unilateral actions, the administration should be working with its allies to put pressure on China to conform to WTO rules where these are applicable. The administration's approach risks weakening adherence to the rules and norms that have contributed to the world economic system's success and a loss of confidence in open markets and enforcement of trade rules.<sup>21</sup>

On the other hand, because many other countries continue to see the system as in their interest, US actions may

---

21. For evidence on the importance of policy certainty on trade and investment decisions, see Crowley and Ciuriak (2018) and Pierce and Schott (2016).

## REFERENCES

- Bachus, James. 2018. *Might Unmakes Right: The American Assault on the Rule of Law in World Trade*. CIGI Papers no. 173 (May). Waterloo: Center for International Governance Innovation.
- Baldwin, Richard. 2016. *The Great Convergence: Information Technology and the New Globalization*. Cambridge: Belknap Press of Harvard University Press.
- Crowley, Meredith, and Dan Ciuriak. 2018. *Weaponizing Uncertainty*. Toronto: C. D. Howe Institute. Available at [www.cdhowe.org/sites/default/files/attachments/research\\_papers/mixed/Final%20Weaponizing%20Uncertainty%20Verbatim\\_Meredith%20and%20Dan\\_2018.pdf](http://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed/Final%20Weaponizing%20Uncertainty%20Verbatim_Meredith%20and%20Dan_2018.pdf).
- Edwards, Lawrence, and Robert Lawrence. 2013. *Rising Tide: Is Growth in Emerging Economies Good for the United States?* Washington: Peterson Institute for International Economics.
- European Union Chamber of Commerce in China. 2017. *China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces*. Available at [www.cscoc.it/upload/doc/china\\_manufacturing\\_2025\\_putting\\_industrial\\_policy\\_ahead\\_of\\_market\\_force%5Benglish-version%5D.pdf](http://www.cscoc.it/upload/doc/china_manufacturing_2025_putting_industrial_policy_ahead_of_market_force%5Benglish-version%5D.pdf).
- Freund, Caroline, Michael Ferrantino, Maryla Maliszewska, Michele Ruta. 2018. *Impacts on Global Trade and Income of Current Trade Disputes*. MTI Practice Notes. Washington: World Bank. Available at <http://documents.worldbank.org/curated/en/685941532023153019/pdf/128644-BRI-PUBLIC-MTI-Practice-Note-2-Final-v2.pdf>.
- Lawrence, Robert Z. 2018. *Five Reasons Why the Focus on the Trade Deficit Is Misleading*. PIIE Policy Brief 18-6. Washington: Peterson Institute for International Economics.
- Lovely, Mary E., and Yang Liang. 2018. *Trump Tariffs Primarily Hit Multinational Supply Chains, Harm US Technology Competitiveness*. PIIE Policy Brief 18-12 (May). Washington: Peterson Institute for International Economics. Available at <https://piie.com/system/files/documents/pb18-12.pdf>.
- Macroy, Patrick F. J., Arthur E. Appleton, and Michael G. Plummer, eds. 2005. *The World Trade Organization: Legal, Economic and Political Analysis*, Volume 1. New York: Springer.
- Noland, Marcus, Sherman Robinson, and Tyler Moran. 2016. Impact of Clinton's and Trump's Trade Proposals. In *Assessing Trade Agendas in the US Presidential Campaign*. PIIE Briefing 16-6 (September). Washington: Peterson Institute for International Economics.
- Pierce, Justin R., and Peter K. Schott. 2016. The Surprisingly Swift Decline of US Manufacturing Employment. *American Economic Review* 106, no. 7: 1632-62.
- US Chamber of Commerce. 2017. *Made in China 2025: Global Ambitions Built on Local Protections*. Available at [www.uschamber.com/report/made-china-2025-global-ambitions-built-local-protections-0](http://www.uschamber.com/report/made-china-2025-global-ambitions-built-local-protections-0).
- USTR (United States Trade Representative). 2017. *Section 301 Report into China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation*. Washington.
- Wu, Mark. 2016. The "China, Inc." Challenge to Global Trade Governance. *Harvard International Law Journal* 57 (Spring): 261-324.

© Peterson Institute for International Economics. All rights reserved.

This publication has been subjected to a prepublication peer review intended to ensure analytical quality. The views expressed are those of the author. This publication is part of the overall program of the Peterson Institute for International Economics, as endorsed by its Board of Directors, but it does not necessarily reflect the views of individual members of the Board or of the Institute's staff or management.

The Peterson Institute for International Economics is a private nonpartisan, nonprofit institution for rigorous, intellectually open, and in-depth study and discussion of international economic policy. Its purpose is to identify and analyze important issues to make globalization beneficial and sustainable for the people of the United States and the world, and then to develop and communicate practical new approaches for dealing with them. Its work is funded by a highly diverse group of philanthropic foundations, private corporations, and interested individuals, as well as income on its capital fund. About 35 percent of the Institute's resources in its latest fiscal year were provided by contributors from outside the United States.

A list of all financial supporters is posted at <https://piie.com/sites/default/files/supporters.pdf>.