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The China Challenge to an Inclusive Asia-Pacific Regional Trade Architecture

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INTRODUCTION

The outcome of the current US-China trade dispute will be a defining issue for both relations between those two countries and the evolving Asia-Pacific regional architecture. The world's two largest economies, and the two largest trading partners of most Asia-Pacific nations, China and the United States together account for \$7.71 trillion in annual two-way trade in goods and services, more than 40 percent of the world total (\$16 trillion).¹ China's economic trajectory could also disrupt East Asian supply-chain patterns. Indeed, the trend of economic nationalism in China and the United States casts a shadow over the future of the institutions, rules, and norms of a global trading system facing an uncertain future.

Any regional or global trade arrangement must include both of the region's largest trading and investing states, or the likely result is a fragmented trade system. China's unfinished transition into a market economy and, thus, inadequate integration into the global trading system, is a major source of US-China trade friction. The extent to which China and the United States rebalance their economic relationship, and reach some eventual accommodation on rules and norms governing economic behavior, could have a large impact on the utility and character of an inclusive regional trade regime in the Asia-Pacific. It will also impact the global trade regime and the future of the World Trade Organization (WTO). How would a global trade regime work if the United States and China were operating under two different sets of rules?

At present, there is no sign of any future WTO global trade-liberalization round. The festering uncertainty

about the future of world trade has led to the rapid development of regional and bilateral free-trade agreements (FTAs) as a hedging tactic. For example, the European Union (EU)—the world's second-largest economy—has concluded, or is in, FTA negotiations with Japan, the Association of Southeast Asian Nations (ASEAN), Mexico, Canada, the *Mercado Común del Sur* (Mercosur), Singapore, and Vietnam. Similarly, in Asia, in addition to the Japan-led Comprehensive and Progressive Agreement for the Trans-Pacific Partnership (CPTPP) there are ongoing negotiations to complete the Regional Comprehensive Economic Partnership (RCEP)—a group of sixteen Asia-Pacific states, plus India. A web of sixty expanding bilateral and plurilateral FTAs in Asia is still growing, with others being negotiated.²

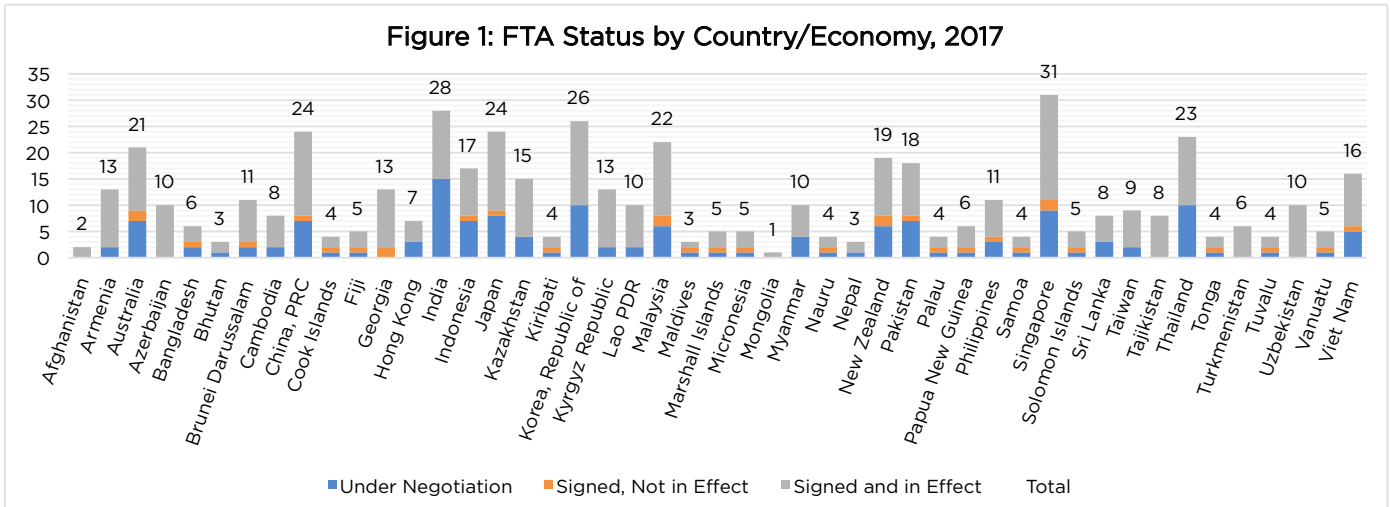
The consequences of a reversal or stagnation of trade liberalization, or competing/conflicting rules around it, could be costly. One study by the Peterson Institute for International Economics (PIIE) suggests that the benefits from trade liberalization from 1950–2016—taking advantage of gains from containerization and other technological advances in transport and communications—added up to \$2.1 trillion. The study projects more than \$500 billion in possible gains from further trade liberalization by 2025.³ These estimates may be on the high end, particularly given the slowdown in trade growth since the 2008–09 financial crisis. The rapid growth of digital commerce and new tech, such as three-dimensional printing, suggests structural changes in globalization itself.⁴ Nonetheless, there is clearly a compelling case that the open, liberal, rules-based order has been, and will continue to be, an important factor driving economic growth.

1 Hong Kong Trade Development Council, "Economic and Trade Information on China," May 15, 2018, <http://china-trade-research.hktdc.com/business-news/article/Facts-and-Figures/Economic-and-Trade-Information-on-China/ff/en/1/1X000000/1X09PHBA.htm>; United States Census Bureau, press release, "Exhibit 1—US International Trade in Goods and Services," https://www.census.gov/foreign-trade/Press-Release/current_press_release/exh1.pdf.

2 Myron Brilliant, "A Free Trade Area of the Asia-Pacific: An Idea with Merit, but Is It Feasible?" Brookings, September 1, 2007, <https://www.brookings.edu/opinions/a-free-trade-area-of-the-asia-pacific-an-idea-with-merit-but-is-it-feasible/>; Pradumma B. Rana and Xianbai Ji, "The Asia-Pacific's Response to Rising US Protectionism," Council of Councils, March 27, 2018, https://www.cfr.org/councilofcouncils/global_memos/p39181.

3 Gary Clyde Hufbauer and Zhiyao (Lucy) Lu, *The Payoff to America from Globalization: A Fresh Look with a Focus on Costs to Workers* (Washington, DC: Peterson Institute for International Economics, 2017), <https://piie.com/system/files/documents/pb17-16.pdf>.

4 Shawn Donnan, "Global Trade: Structural Shifts," *Financial Times*, March 2, 2016, <https://www.ft.com/content/OeOe6960-da17-11e5-98fd-06d75973fe09>.



Source: Modified from Asia Regional Integration Center, ADB; Office of the United States Trade Representative

HOW WE GOT HERE: US ASSUMPTIONS UNDERMINED



Alibaba Group headquarters in Hangzhou, China.

Source: https://commons.wikimedia.org/wiki/File:Alibaba_group_Headquarters.jpg

From its onset seventy years ago in the aftermath of World War Two, the global trading system—the General Agreement on Tariffs and Trade (GATT) and its successor, the WTO—has been a key driver of economic growth and prosperity. World trade grew nine-fold, from \$2.05 trillion in 1980 to \$19 trillion by 2014.⁵ Yet, stagnant middle-class wages and waves of immigrants escaping Middle Eastern chaos helped create a populist backlash in Europe and the United States with regard to free trade, which continues to percolate. China's role, US-China trade confrontation, Donald Trump's economic nationalism, and creeping protectionist measures worldwide—seven thousand adopted since 2008—are additional factors on which the future of the global trading system will turn.⁶

Historically, US leadership and the institutional arrangements under the Breton Woods system—the International

Monetary Fund (IMF), World Bank, International Finance Corporation (IFC), and the GATT/WTO—have been vitally important to prosperity in the Asia-Pacific region. The United States was instrumental in facilitating China's integration into the international economic system, from its own trade and foreign direct investment (FDI) involving China to China's 2001 accession into the WTO. Driven by low wages and FDI—for a developing nation, China was unusually open to FDI—China became the world's factory, averaging nearly 10 percent annual growth for more than two decades, until recently.⁷ At its peak, foreign-invested businesses accounted for 58.3 percent of China's exports and 59.7 percent of its imports, and currently more than one-third of all value added on Chinese exports.⁸ China's economic growth was breathtaking: from \$1.2 trillion gross domestic product (GDP) in 2000 to \$11.2 trillion GDP by 2016.⁹

5 Statista, "Trends in Global Export Volume of Trade in Goods from 1950 to 2016 (In Dollars)," July 2017, <https://www.statista.com/statistics/264682/worldwide-export-volume-in-the-trade-since-1950>.

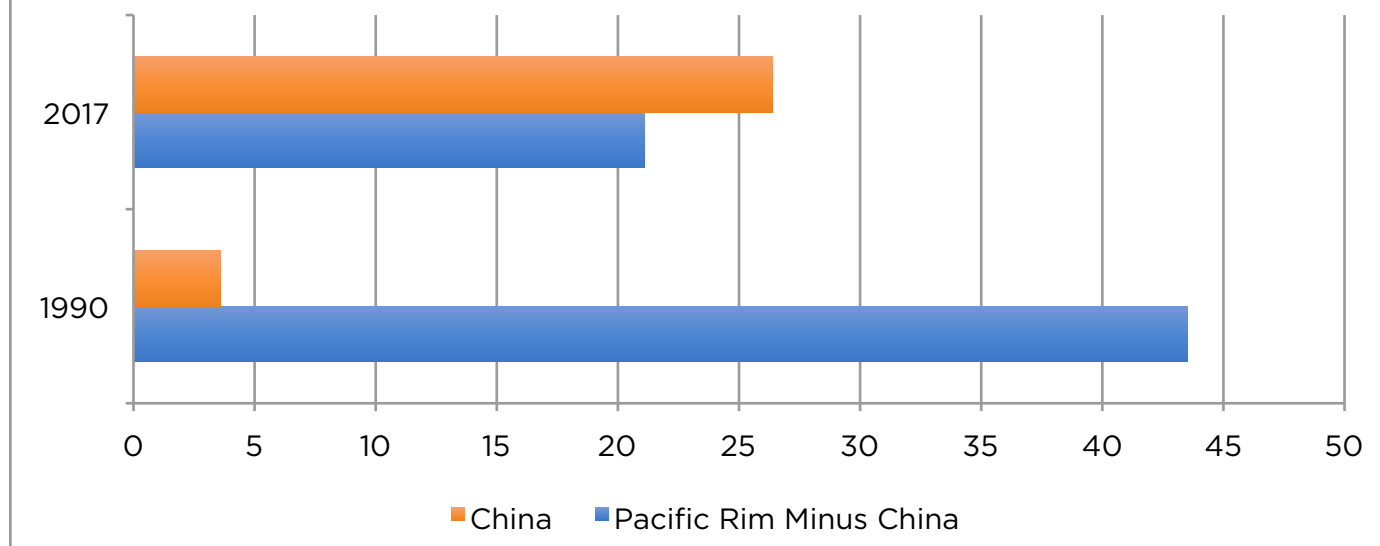
6 Marc Jones, "World Has Racked up 7,000 Protectionist Measures Since Crisis: Study," Reuters, November 14, 2017, <https://www.reuters.com/article/us-global-economy-protectionism/world-has-racked-up-7000-protectionist-measures-since-crisis-study-idUSKBNIDF005>.

7 Trading Economics, "China GDP Annual Growth Rate 1989-2018," 2018, <https://tradingeconomics.com/china/gdp-growth-annual>.

8 Wayne M. Morrison, "China's Economic Rise: History, Trends, Challenges, and Implications for the United States," Congressional Research Service, February 5, 2018, p. 14, <https://fas.org/sgp/crs/row/RL33534.pdf>.

9 Trading Economics, "China GDP 1989-2018," 2018, <https://tradingeconomics.com/china/gdp>.

Figure 2: US Manufactured Imports from Pacific Rim Countries as a Percentage of Total US Manufactured Imports: 1990 and 2017



Source: United States International Trade Commission DataWeb.

Note: Standard International Trade Classification (SITC) definition of manufactured imports

The unanticipated pace and scope of Chinese growth, accelerated by Chinese state-centric practices, overwhelmed the global trade regime and generated a backlash against free trade in the United States. The United States lost more than five million manufacturing jobs from 1990–2010. There are conflicting studies and debate with regard to how many of the job losses were caused by China’s manufacturing boom, and how many were due to technology and automation. One major study attributed more than two million job losses to China, while others argued the losses were greater.¹⁰ Another oft-cited study argued that more than 80 percent of job losses were due to technology and automation (e.g., robotics).¹¹

The view that trade with China was a major source of US economic malaise was a prominent theme in Donald Trump’s 2016 presidential election campaign. Such views eroded the underpinnings of bipartisan support for US-China policy, not least in the US business

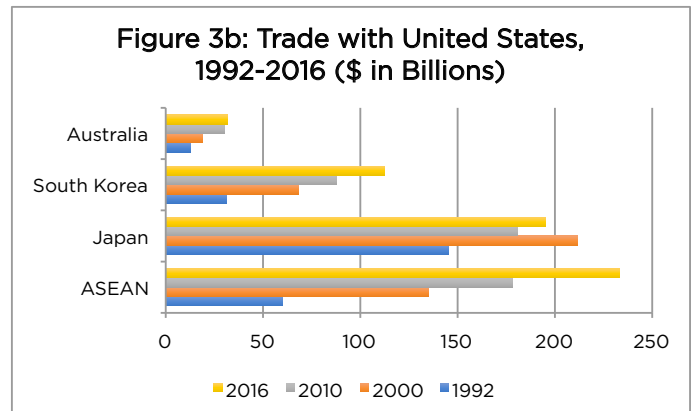
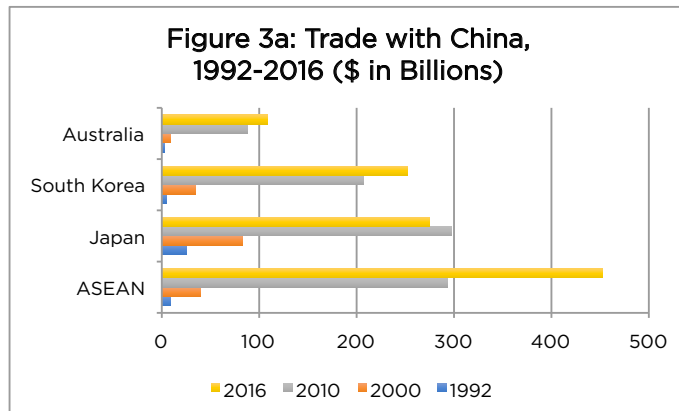
community, a foundational pillar of such bipartisan support. A core assumption underlying US optimism was that economic reform would continue, and that as it more fully integrated into and benefited from the international economic system, China would seek to advance its own economic and geopolitical interests within established institutional arrangements, rather than challenging existing structures or writing its own rules. This has proven at least partially untrue. A related assumption was that China growing a large middle class would lead to further economic, if not political, reforms; this also has not been borne out by reality.

These largely discredited assumptions began to dissolve the bipartisan consensus behind US policy toward China, even before Trump took office. A good example of shifting US views was a mea culpa written by two senior Barack Obama administration Asia advisers about how the United States got China wrong.¹² A 2017 US

¹⁰ Daron Acemoglu, David Autor, David Dorn, Gordon H. Hanson, and Brendan Price, *Import Competition and the Great U.S. Employment Sag of the 2000s* (Cambridge, Mass.: National Bureau of Economic Research, 2014), <http://www.nber.org/papers/w20395.pdf>; For the ongoing debate, see Steve LeVine, “China Blamed for Destroying U.S. Manufacturing,” *Axios*, May 14, 2018, https://www.axios.com/many-economists-are-now-blaming-trade-ebd7d540-74a1-405c-b63e-3d11129d3b48.html?utm_source=sidebar&utm_medium=email&utm_campaign=newsletter_axiosfutureofwork&stream=future-of-work.

¹¹ Federica Cocco, “Most US Manufacturing Jobs Lost to Technology, Not Trade,” *Financial Times*, December 2, 2016, <https://www.ft.com/content/dec677c0-b7e6-11e6-ba85-95d1533d9a62>.

¹² Kurt M. Campbell and Ely Ratner, “The China Reckoning: How Beijing Defied American Expectations,” *Foreign Affairs*, March/April 2018, <https://www.foreignaffairs.com/articles/united-states/2018-02-13/china-reckoning>.



Source: World Bank World Integrated Trade Solution (WITS) database for data on China; United States Census Bureau for data on United States

Chamber of Commerce survey found that 80 percent of US businesses in China felt less welcome than in the past.¹³ Increasing difficulty doing business in China has diminished one of the key pillars of US policy toward China.¹⁴ One expression of this shift is increased skepticism and tougher scrutiny of Chinese investment in the United States, particularly in the technology sector.¹⁵

In some respects, China has abided by the norms of the Bretton Woods system (particularly with regard to the IMF and World Bank), responding to WTO rulings and also using the WTO to pursue its own trade grievances. However, the breakneck rapidity of China’s growth outpaced the terms on which it acceded to the WTO. As bilateral trade in goods and services grew—reaching nearly \$700 billion in 2017—the US trade deficit with China hit \$375 billion, more than half the global total.¹⁶ China skillfully gamed the system, benefiting from its outmoded WTO status as a “developing economy” and its mercantilist trade and industrial policies. Indeed, a remarkable conclusion in the United States Trade Representative’s (USTR’s) annual report on China’s WTO compliance asserted that “the United States erred in supporting China’s entry into the WTO on terms that have proven to be ineffective in securing China’s embrace of an open, market oriented trade regime.”¹⁷

A new US consensus on China policy is slowly taking shape, characterized by a growing suspicion of Beijing’s strategic intentions, renewed efforts to counter Beijing geopolitically, and a strong imperative to rebalance the US-China economic relationship—which has been distorted by China’s increasingly mercantilist trade and industrial policies, and its predatory methods to acquire technology (e.g., coercive transfer of technology, cybertheft, and curbs on investment in key sectors). The Trump administration’s National Security Strategy document, while citing a need for continued cooperation on some issues, defines China as a “strategic competitor” seeking “to displace the United States in the Indo-Pacific region, expand the reaches of its state-driven economic model and reorder the region in its favor.”¹⁷ This is a clear shift from the previous modus operandi of US policy: cooperate with China where possible, and manage differences. China remains a work in progress, one that claims its policies are shaped pragmatically, by “crossing the river by feeling for stones.”

The Mercantilist Problem

Strengthening the foundation of US-China economic relations will require Beijing to narrow the large gap between its platitudinous rhetoric and its predatory

13 Michael Martina, “US Lobby Says China Protectionism Fueling Foreign Business Pessimism,” Reuters, January 17, 2017, <https://www.reuters.com/article/us-china-usa-business-idUSKBN1520EY>.
 14 Wendy Wu, “Is China Making Life Difficult for Foreign Companies?” South China Morning Post, May 30, 2016, <http://www.scmp.com/news/china/diplomacy-defence/article/1940397/china-making-life-difficult-foreign-companies>.
 15 Cecilia Kang and Alan Rappeport, “The New U.S.-China Rivalry: A Technology Race,” New York Times, March 6, 2018, <https://www.nytimes.com/2018/03/06/business/us-china-trade-technology-deals.html>; For US business views, see Made in China 2025: Global Ambitions Built on Local Protections (Washington, DC: US Chamber of Commerce, 2017), https://www.uschamber.com/sites/default/files/final_made_in_china_2025_report_full.pdf.
 16 US Census Bureau, “Trade in Goods with China,” <https://www.census.gov/foreign-trade/balance/c5700.html#2017>.
 17 US White House, National Security Strategy of the United States of America, December 25, 2017, <https://www.whitehouse.gov/wp-content/uploads/2017/12/NSS-Final-12-18-2017-0905.pdf>.

economic behavior. President Xi Jinping postures as a champion of free trade. Most famously, in a 2017 speech to the World Economic Forum, Xi audaciously offered China as champion of the open, rules-based order: “We must remain committed to developing global free trade and investment, promote trade and investment liberalization and facilitation through opening-up and say no to protectionism. Pursuing protectionism is like locking oneself in a dark room.”¹⁸

China’s actual trade and industrial policies have, in large measure, been the opposite. The current tension over Chinese steel and aluminum dumping reflects long-standing policies of subsidizing what Beijing defines as strategic and “heavyweight” industries: energy (oil, gas, coal, electric power); telecommunications; civil aviation; shipping; machinery; autos; iron, steel, and non-ferrous metals; construction; and information technology (IT), among others. There are a variety of means of state support, including tax rebates, preferential loans, grants, energy subsidies, import tariffs, transferring assets at less than fair value, and restricting competing foreign investment. In addition, there are a variety of formal and informal legal and regulatory tactics to impede foreign competition. For example, electric auto manufacturers in China must use Chinese batteries.¹⁹

The result of such trade-distorting policies has been overcapacity in steel and other sectors. In 2000, China accounted for 16 percent of global production and was a net importer of steel. By 2017, after some \$30 billion in subsidies, China accounted for 50 percent of world steel production and was undercutting Organization for Economic Cooperation and Development (OECD) steel export prices by 25 percent.²⁰ Similarly, over the past decade, subsidies to Chinese solar-panel firms have led to a tenfold increase in solar-panel manufacturing, lowering global prices by 75 percent. This pattern of subsidies—leading to excess capacity and, hence, distorting global markets—has been repeated in a number of other industries.²¹

Who Dominates the Future?

The trade confrontation is about more than steel and aluminum tariffs, dumping, or Chinese overcapacity from heavily subsidized industries. These are relatively manageable aspects of the trade problem. Fundamentally, the confrontation is about technology: about China, by hook or by crook, seeking to dominate the economy of the future by employing similar mercantilist techniques to develop new strategic technologies. The response to China’s predatory industrial policies comes at a pivotal moment: an evolving technology revolution, one more transformational by an order of magnitude than the personal computer/Internet revolution of the 1990s, is gathering momentum.

What is unfolding is a convergence of technologies, the fusion of the digital with the real economy, in a synergy of artificial intelligence (AI), big data (the cloud), robotics, biotech, advanced manufacturing, the Internet of Things (IoT), nano-engineering, and nano-manufacturing. This has been dubbed the “Fourth Industrial Revolution.”

This tech revolution will be a key driver of economic growth, comprehensive national strength, and, thus, geopolitical status in the two decades ahead. This is well understood by Chinese leaders. As Xi Jinping said at the Nineteenth Party Congress in October 2017, “Innovation is the primary force driving development, and it is the strategic underpinning for building a modernized economy.”²²

It is in this context that China’s policies—and the US and global responses to them—must be viewed. Chinese techno-nationalism is a longstanding propensity. Mao Zedong’s China—faced with threats from the United States and, after the Sino-Soviet split, from the Soviet Union—saw a need for economic self-sufficiency and investment in strategic technologies.²³ During the first wave of economic reforms, Chinese leader Deng Xiaoping in 1986 approved a high-tech research and

18 The People’s Republic of China State Council Information Office, “Full Text: Xi Jinping’s Keynote Speech at the World Economic Forum,” April 6, 2017, http://www.china.org.cn/node_7247529/content_40569136.htm.

19 One interesting exception is China-owned Volvo, which is permitted to use Korean batteries: Trefor Moss, “Power Play: How China-Owned Volvo Avoids Beijing’s Battery Rules,” Wall Street Journal, May 17, 2018, <https://www.wsj.com/amp/articles/power-play-how-china-owned-volvo-avoids-beijings-battery-rules-1526551937>.

20 Usha C.V. Haley and George T. Haley, “How Chinese Subsidies Changed the World,” Harvard Business Review, April 25, 2013, <https://hbr.org/2013/04/how-chinese-subsidies-changed>.

21 Ibid.

22 “19th Party Congress: Xi Jinping Seeks to Turn China into a Nation of Innovators,” Straits Times, October 18, 2017, <https://www.straitstimes.com/asia/east-asia/19th-party-congress-xi-jinping-calls-for-turning-china-into-nation-of-innovators>.

23 Well chronicled in Evan A. Feigenbaum, *China’s Techno-Warriors: National Security and Strategic Competition from the Nuclear to the Information Age* (Redwood City, Calif.: Stanford University Press, 2003).



President Trump participates in a bilateral meeting with President Xi in Beijing on November 9, 2017
Source: https://www.whitehouse.gov/wp-content/uploads/2017/12/6f3a2039_original-1024x683.jpg

development (R&D) program focusing on technologies such as IT, robotics, space, biotechnology, and lasers.²⁴ A similar program followed in 1997.

In 2006, China formally adopted “indigenous innovation”—state-backed industrial policy. Xi took it to a new level in 2013 with the “Made in China 2025” (MIC2025) plan, which targeted ten strategic technologies, including semiconductors, next-generation IT, robotics/smart manufacturing, autonomous vehicles, new materials, aerospace, biotech, and advanced rail equipment.²⁵ In July 2017, China’s State Council announced a plan to dominate AI by 2030.²⁶ Xi Jinping has been clear about intent: “We will move Chinese industries up to the medium-high end of the global value chain and foster a number of world-class advanced manufacturing clusters.”²⁷ MIC2025 seeks to achieve 70 percent Chinese local production in these priority technologies by 2025. A variety of overlapping government funding

and subsidies (e.g., housing, tax holiday, electricity) at national, provincial, and city government levels is dedicated to each priority tech sector. In total, that adds up to more \$300 billion in government investment funds.²⁸

The issue is not industrial policy, per se, though the magnitude of state funding is a major concern. Many nations have industrial policies of one sort or another, prioritize government R&D funding, and/or incentivize private-sector investment in key tech industries. Indeed, Germany has its “Industrie 4.0,” to which MIC2025 bears some resemblance.²⁹ The problem is primarily about means, not ends. What is at issue are rules and norms, reciprocal trade, and investment behavior. It is about how China acquires technology: cybertheft of intellectual property (IP) and proprietary business information; imposing de facto coercive transfer of technology as the price of market access; forcing investors into joint ventures and/or limiting ownership to 49 percent; and using an opaque regulatory and legal system and other informal barriers, while providing excessive subsidies to targeted Chinese firms.

A recent US Chamber of Commerce report says, “China’s industrial policies, Internet and data legal and regulatory frameworks, and inward foreign direct investment regime (the most restrictive of all G20 economies) suggest limited support for globalization and competitive markets.”³⁰ The danger is that, even if China is only partially successful in realizing its aspirations to create largely internal value chains in targeted tech sectors, it could pose structural challenges to the global economy. Consider e-commerce, where China is already a leading global player. China’s “Great Firewall,” its call for oxymoronic “Internet sovereignty,” and its efforts to localize where commercial data are stored are, according to the US Chamber of Commerce, “skewing the decision-making process for companies that must decide where products are made and innovation takes place.”³¹

24 Ministry of Science and Technology of the People’s Republic of China, “S&T Programme—National High-Tech R&D Program (863 Program),” <http://most.gov.cn/eng/programmes1>.

25 For a detailed assessment of China’s Made in China 2025 industrial strategy, see Jost Wübbeke, Mirjam Meissner, Max J. Zenglein, Jaqueline Ives, and Björn Conrad, *Made in China 2025: The Making of a High-Tech Superpower and Consequences for Industrial Countries* (Berlin: Mercator Institute for China Studies, 2016), https://www.merics.org/sites/default/files/2017-09/MPOC_No.2_MadeinChina2025.pdf.

26 Paul Mozur, “Beijing Wants A.I. to Be Made in China by 2030,” *New York Times*, July 20, 2017, <https://www.nytimes.com/2017/07/20/business/china-artificial-intelligence.html>.

27 “Full Text of Xi Jinping’s Report at 19th CPC National Congress,” *China Daily*, October 18, 2017, http://www.chinadaily.com.cn/china/19thcpcnationalcongress/2017-11/04/content_34115212.htm.

28 Wübbeke et al., *Made in China 2025*, pp. 23–24.

29 Demetrius Kiltou, Johannes Conrads, Morten Rasmussen, Laurent Probst, and Bertrand Pedersen, *Germany: Industrie 4.0* (Brussels: European Commission Digital Transformation Monitor, 2017), https://ec.europa.eu/growth/tools-databases/dem/monitor/sites/default/files/DTM_Industrie%204.0.pdf

30 US Chamber of Commerce, *Made in China 2025*, p. 11.

31 *Ibid.*

Pushing Back: Toward a New Normal?

The growing sense of peril in the United States, as well as in Europe and Japan, with regard to China's economic behavior has generated a backlash against assertive efforts by major Chinese tech firms to acquire US tech firms and startups, and—in the case of Chinese telecom firms Huawei and ZTE—curbed their access to US markets. ZTE, however is in a separate category. The US Treasury Department hit ZTE with \$1.19 billion in penalties in March 2017 for violating sanctions by selling telecom equipment to Iran and North Korea, and the Commerce Department banned the Chinese tech firm from buying chips and other components for seven years. As ZTE buys 60 percent of its chips and components from US firms, these moves pushed it to the brink of insolvency.³² But, the Trump administration appears to have turned a law-enforcement decision into a trade bargaining chip. Trump has reached a deal to lift the ban on ZTE buying US chips and software. Under the agreement, ZTE is to: pay a \$1 billion fine; place \$400 million in escrow, to be forfeited if there are future violations; hire a compliance team selected by the United States to monitor its business activities; and, if the agreement is violated, be banned from buying US chips and components for ten years.³³ If finalized, this deal would be a dangerously shortsighted tradeoff and loss of leverage on technology issues, a top US priority. In response, a bipartisan group of twenty-seven senators signed a letter urging the administration not to soften technology controls on China in exchange for more sales, and a bipartisan group in Congress is pursuing legislation—an amendment to the Defense Authorization Act—that

would reverse the administration's ZTE deal and impose tougher restrictions on other Chinese firms.³⁴

Since 2016, a growing number of high-profile attempted Chinese acquisitions of US firms were blocked on national security grounds. Earlier this year, the United States blocked the takeover of Xcerra, a microchip firm, by a state-backed Chinese company.³⁵ The purchase of a US e-payment firm by a Chinese firm owned by the tech giant Alibaba was similarly blocked.³⁶

Along with a threat of imposing \$150 billion in tariffs on Chinese imports, and efforts to reduce the trade deficit, the Trump administration is looking to further restrict Chinese investment in key tech sectors, and Congress is pursuing legislation to tighten trade and investment restrictions on national security grounds.³⁷ In 2016, Germany vetoed a high-profile Chinese takeover of a major semiconductor firm, and has already tightened restrictions on Chinese tech buyouts.³⁸ Similarly, the EU is drafting legislation to restrict Chinese investment in tech sectors.³⁹ In addition, there is growing US-EU-Japan trilateral cooperation in the WTO in response to China's tech-transfer policies.⁴⁰

The entire spectrum of market-distorting barriers to trade and investment transgressions is detailed in the Office of the United States Trade Representative's Section 301 (of the Trade Act of 1974) investigation of China's policies with regard to tech transfer, IP, and innovation, and its annual report on foreign trade barriers.⁴¹ These assessments shape the framework of ongoing US-China negotiations.

32 Damian Paletta, Ellen Nakashima, Steven Mufson, and Tony Romm, "Penalties against China Telecom Giant ZTE Become a Bargaining Chip as White House, Chinese Officials Discuss Potential Trade Deal," *Washington Post*, May 13, 2018, https://www.washingtonpost.com/news/the-switch/wp/2018/05/13/trump-pledges-to-help-chinese-phone-maker-zte-get-back-into-business/?utm_term=.2be91ab954ce.

33 Shawn Donnan and Pan Kwan Yuk, "US Strikes Deal with ZTE to Lift Ban," *Financial Times*, June 7, 2018, <https://www.ft.com/content/d001be46-6a4d-11e8-8cf3-0c230fa67aec>.

34 "US lawmakers scramble to roll back Donald Trump's deal to reopen ZTE," *South China Morning Post*, June 8, 2018, <http://www.scmp.com/news/china/diplomacy-defence/article/2149807/us-lawmakers-scramble-roll-back-donald-trumps-deal>.

35 Raymond Zhong, "U.S. Blocks a Chinese Deal Amid Rising Tensions Over Technology," *New York Times*, February 23, 2018, <https://www.nytimes.com/2018/02/23/technology/china-microchips-cfius-xcerra.html>.

36 Greg Roumeliotis, "United States Blocks MoneyGram Sale to China's Ant Financial on National Security Concerns," *Reuters*, January 2, 2018, <https://www.reuters.com/article/us-moneygram-intl-m-a-ant-financial/u-s-blocks-moneygram-sale-to-chinas-ant-financial-on-national-security-concerns-idUSKBN1ER1R7>.

37 Nancy Fischer, Stephan E. Becker, Matthew R. Rabinowitz, and Sahar Hafeez, "New Proposed Trade Legislation Contains Additional Trade and Investment Restrictions Involving China," *Global Trade and Sanctions Law*, May 18, 2018, <https://www.globaltradeandsanctionslaw.com/2018/05/18/new-proposed-trade-legislation-contains-additional-trade-and-investment-restrictions-involving-china>.

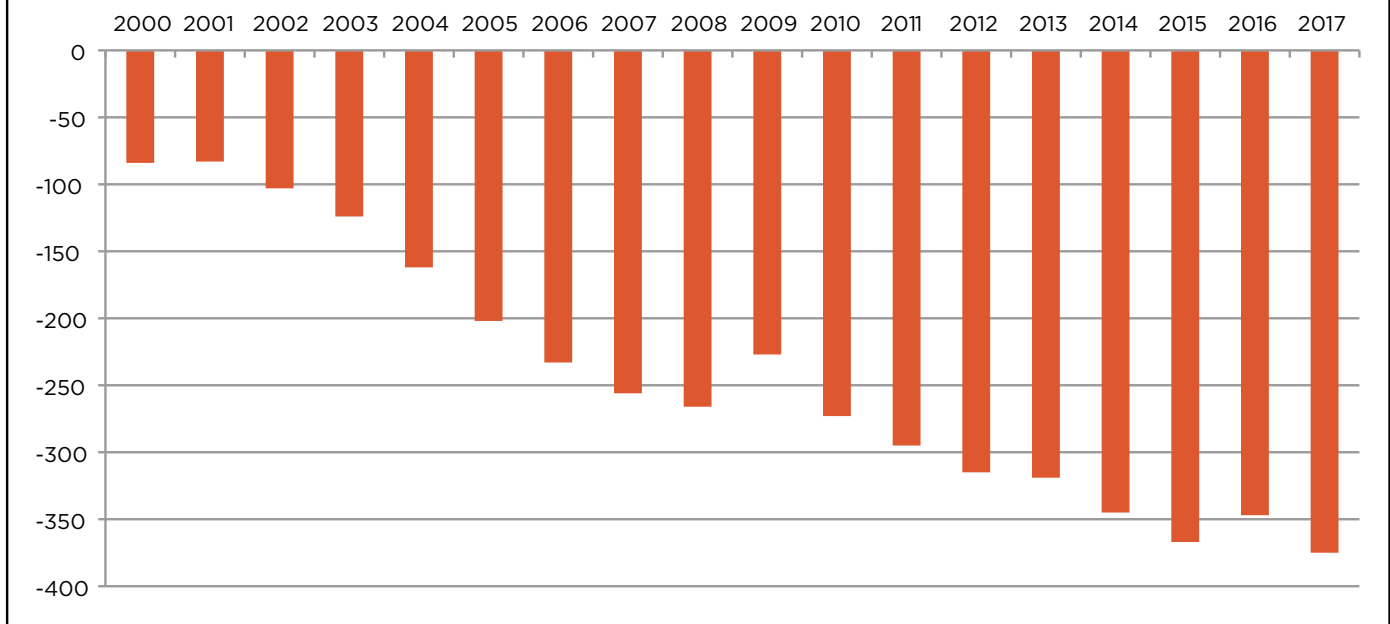
38 Pamela Barbaglia, Rene Wagner, and Arno Schuetze, "Germany Sets EU Tone with Tighter Curbs on Foreign Takeovers," *Reuters*, July 11, 2017, <https://www.reuters.com/article/us-germany-m-a/germany-sets-eu-tone-with-tighter-curbs-on-foreign-takeovers-idUSKBN19W2R6>; On Aixtron veto, see Paul Mozur, "Germany Withdraws Approval for Chinese Takeover of Aixtron," *New York Times*, October 24, 2016, <https://www.nytimes.com/2016/10/25/business/dealbook/germany-china-technology-takeover.html>.

39 "EU Drafting Law to Restrain Chinese Takeovers," *Deutsche Welle*, January 28, 2018, <http://www.dw.com/en/eu-drafting-law-to-restrain-chinese-takeovers/a-42339012>.

40 "WTO Case Eyed Over China's Forced Technology Transfers," *Asia News Network*, February 15, 2018, <http://annx.asianews.network/content/wto-case-eyed-over-china%E2%80%99s-forced-technology-transfers-67166>.

41 Office of the United States Trade Representative, "Findings of the Investigation into China's Acts, Policies, and Practices Related to

Figure 4: US Merchandise Trade Balance with China: 2000-2017 (\$ in Billions)



Source: United States International Trade Commission DataWeb

Success in persuading China to revise its trade and industrial policies, so that they are more in line with market forces and international rules and norms, will require global cooperation. The sheer weight of the US-China economic relationship puts the United States unavoidably centerstage in the effort. The collateral damage to other US trading partners that the Trump administration’s threatened sanctions would impose, along with Trump’s economics-defying demands that China reduce its trade surplus with the United States by \$200 billion in twenty-four months, has taken many aback. Such tactics complicate efforts to achieve desired results, but they do not detract from the merit of the core indictment of Chinese policies.

Trump’s counterpunching appears to be getting Beijing’s attention. Like Google or Amazon, China’s “big tech” companies—Alibaba, Baidu, JD.com, Tencent, Huawei—see

themselves as global multinationals. Tencent alone has bought up 277 tech startups in the United States and elsewhere since 2013.⁴² Chinese tech firms have invested more than \$12 billion in US tech startups, in nearly one hundred deals over the past four years.⁴³ Growing restrictions on Chinese investment and market access may increase internal pressures for liberalization.

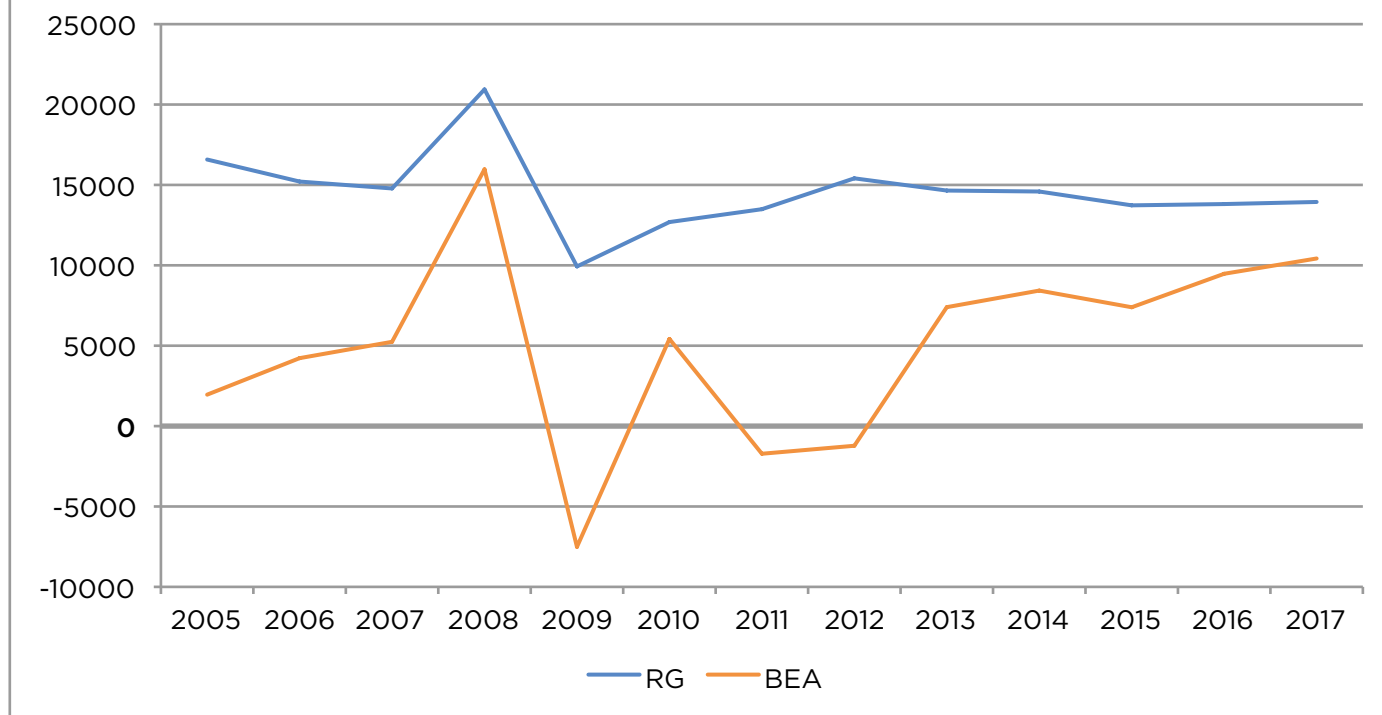
In a major speech on the future of economic reform—given in April at the Boao Forum, China’s copycat version of Davos—Xi Jinping appeared to respond to US grievances. Assuring more reform and opening, Xi pledged to: reduce auto tariffs; increase imports; strengthen protection of IP; and raise foreign-equity caps in securities, banking, insurance industries, and autos. In addition, Xi said China would “enhance alignment with international economic and trading rules.” Importantly, Xi also pledged to “finish revision of the negative list (deciding

Technology Transfer, Intellectual Property, and Innovation Under Section 301 of the Trade Act of 1974,” March 22, 2018, <https://ustr.gov/sites/default/files/Section%20301%20FINAL.PDF>; Office of the United States Trade Representative, “2018 National Trade Estimate Report on Foreign Trade Barriers,” March 27, 2018, pp. 91-110, <https://ustr.gov/sites/default/files/Press/Reports/2018%20National%20Trade%20Estimate%20Report.pdf>.

42 Liza Lin and Julie Steinberg, “How China’s Tencent Uses Deals to Crowd Out Tech Rivals,” *Wall Street Journal*, May 15, 2018, <https://www.wsj.com/articles/how-chinas-tencent-uses-deals-to-crowd-out-tech-rivals-1526392800>.

43 David J. Lynch, “Trump’s Next Round of Trade Limits Could Hurt the US Tech Industry He Wants to Help,” *Washington Post*, May 21, 2018, https://www.washingtonpost.com/business/economy/trumps-next-round-of-trade-limits-could-hurt-the-us-tech-industry-he-wants-to-help/2018/05/21/7b2507ee-587c-11e8-b656-a5f8c2a9295d_story.html?utm_term=.528b10f9d7f0.

Figure 5: Bureau of Economic Analysis (BEA) and Rhodium Group (RG) Data on Annual US FDI flows to China: 2005-2017 (\$ in Millions)



Source: Bureau of Economic Analysis and the Rhodium Group
 Note: BEA and RG methodologies for measuring FDI differ significantly

which sectors are open) on foreign investment,” which could provide an opening to restart negotiations on a bilateral investment treaty (BIT).⁴⁴

It is tempting to discount such rhetoric, as it appears counter to the broad Chinese trend of tighter political and economic controls, as well as the fact that some promises—such as those regarding auto tariffs or intellectual property rights (IPR)—have been made previously, without results. But, Xi made a point in emphasizing “that with regard to all those major initiatives of opening-up that I have just announced, we have every intention to translate them into reality, sooner rather than later.”⁴⁵ In the weeks following Xi’s speech, Beijing has reduced auto tariffs to 15 percent, and opened finance and insurance industries to foreign investment. If Beijing implemented all of Xi’s promises,

that would address many US trade and investment concerns. Regardless of Xi’s intentions, however, his speech offers a reform menu to measure China’s sincerity against—and a tool to play back to Beijing in negotiations.

Trump China Economic Strategy: Local or Global?

US Trade Representative Robert E. Lighthizer succinctly summed up US objectives: “Getting China to open its market to more US exports is significant, but the far more important issues revolve around forced technology transfers, cyber theft and the protection of our innovation.”⁴⁶ He added, “As this process continues, the United States may use all of its legal tools to protect our technology through tariffs, investment

44 “Transcript: President Xi Addresses the 2018 BOAO Forum for Asia in Hainan,” US-China Perception Monitor, April 11, 2018, <https://www.uscnpm.org/blog/2018/04/11/transcript-president-xi-addresses-2018-boao-forum-asia-hainan>.

45 Ibid.

46 Zachary Warmbrodt and Doug Palmer, “China Trade War ‘On Hold’ as Trump Pauses Tariffs,” Politico, May 20, 2018, <https://www.politico.com/story/2018/05/20/mnuchin-china-trade-war-598481>.

restrictions and export regulations. Real structural change is necessary.”⁴⁷

How the Trump administration seeks to remedy the nexus of trade and investment grievances against China is a tactical question with global repercussions. The joint statement issued at the end of trade talks on May 19, 2018, was vague, referencing agreement on taking steps to reduce the deficit, with China buying more from the United States. But, it also alluded to China amending its laws and regulations with regard to IPR and patents.⁴⁸ The hope is that US leverage will be employed to rebalance the US-China trade relationship—not only with tailored bilateral arrangements, but by attaining revised Chinese policies to provide more reciprocal market access, writ large.

While most of Trump’s grievances about Chinese trade and industrial policies are valid, he has strongly held unorthodox views on trade, at odds with standard economics. Rather than viewing trade as an equal exchange of goods and services (e.g., one buys a bike and gives the seller \$200, a fair exchange) Trump views the measure of a bilateral trade arrangement as whether the United States has a deficit or surplus with a country. He has condemned most current bilateral and multilateral trade deals (e.g., the North American Free Trade Agreement (NAFTA) or the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)) on that basis. But, trade deficits are the result of macroeconomic factors—savings rates, investment flows, currency rates, whether one consumes more than one produces. This misreading of cause and effect leads to flawed tactics in remedying the problem.

The purpose of trade agreements is to create more market access for goods and services, not to guarantee outcomes. Moreover, in an economy of global supply chains, trade statistics can be deceptive. When China sells an iPhone, it counts as a Chinese export, but more than 80 percent of its value is based on inputs (e.g., screens and chips) from the Republic of Korea (ROK), Taiwan, and other suppliers.⁴⁹ On the other end,

a Toyota manufactured in the United States and sold abroad is tallied as a US export.

That said, when the United States runs an enormous and growing deficit with China for more than two decades, it is reasonable to examine structural factors. USTR’s Section 301 investigation leaves no doubt that, in the case of China, there are major restrictions on market access. One concern, however, is that US preoccupation with the trade deficit may result in managed trade—that is, political decisions, rather than markets, determining trade flows. This can take the form of a quid pro quo, buying more goods in exchange for easing market-opening pressures, quotas, or voluntary export restraints. The *Wall Street Journal* has opined that this is ill-suited to the complex world of global supply chains, concluding that “negotiated quotas will damage US competitiveness and do little do alter the trade balance.”⁵⁰

In an effort to meet Trump’s demand to reduce the trade deficit by \$200 billion, China is offering to buy more US agricultural goods, computer chips, and oil and gas, in exchange for tariff relief. This could ease the deficit modestly, but it is unlikely to reach more than a fraction of the total amount. The US economy is running at near capacity, and while some sectors like liquefied natural gas (LNG) are growing, there is little prospect of greatly expanding production.

While China buying goods from the United States is part of a more balanced relationship, far more important is gaining reciprocal market access—both bilaterally and through new WTO agreements in emerging technology sectors, and others where the United States is competitive. For example, the United States already runs a \$37 billion *surplus* with China in services.⁵¹ Pressing Xi Jinping to fully implement his opening of banking, finance, and insurance industries to foreign investment would play to the US advantage. China’s business-services sector is relatively underdeveloped. Further opening the Chinese services sector could provide new opportunities for US firms.⁵²

47 Ibid.

48 US White House, press release, “Joint Statement of the United States and China Regarding Trade Consultations,” May 19, 2018, <https://www.whitehouse.gov/briefings-statements/joint-statement-united-states-china-regarding-trade-consultations>.

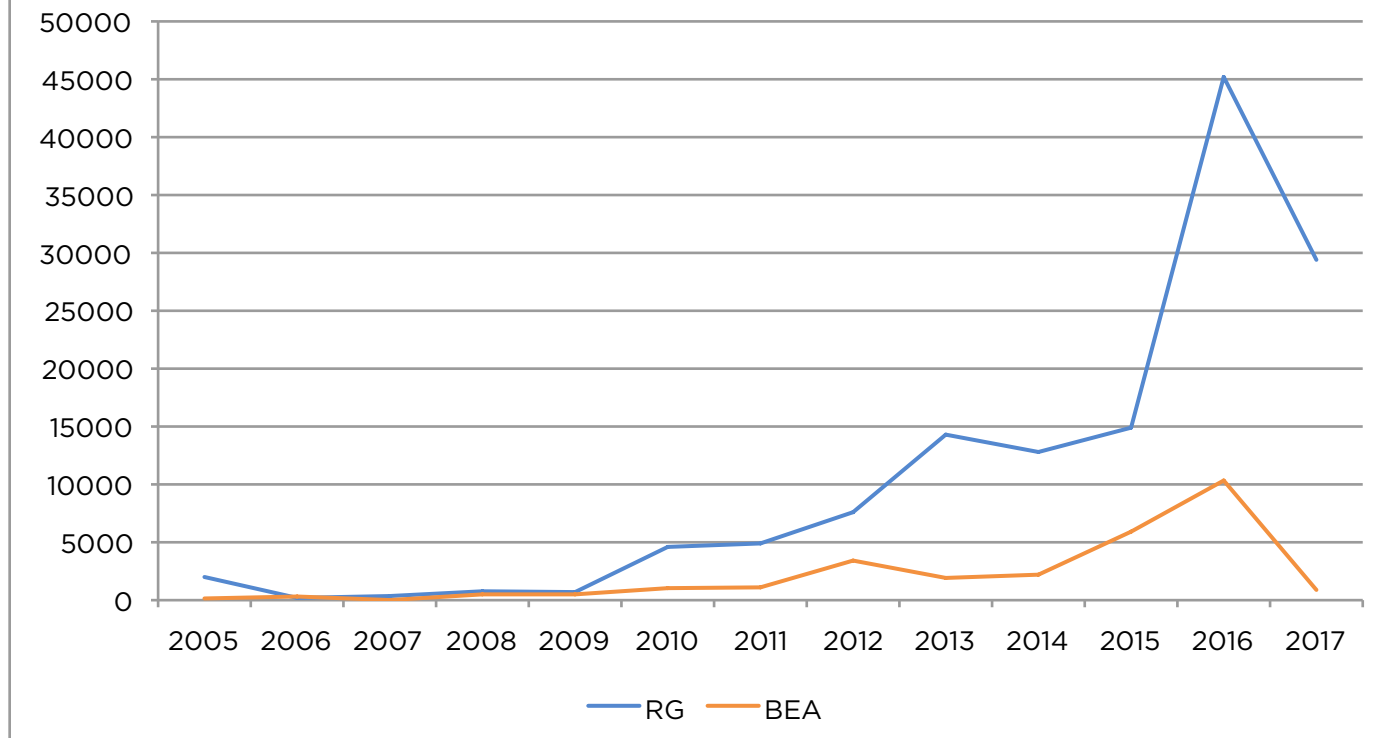
49 Peter Marber, “The iPhone isn’t All Made in China, but US Import Statistics Say It is. Why the Global Economy Must Demand Accurate Data,” Quartz, November 26, 2012, <https://qz.com/31076/the-iphone-isnt-all-made-in-china-but-us-import-statistics-say-it-is-why-the-global-economy-must-demand-accurate-data>.

50 Editorial Board, “Trump’s Managed Trade: The Revised Korea Deal Favors Detroit and Steel Over US Consumers,” *Wall Street Journal*, March 29, 2018, <https://www.wsj.com/articles/mr-lighthizers-managed-trade-1522278003>.

51 Morrison, *China-US Trade Issues*, p. 10.

52 Lee G. Branstetter, Britta Glennon, and J. Bradford Jensen, “The Importance of Doing Our BIT: The Economic Potential of a US-China Bilateral Investment Treaty,” in Adam S. Posen and Jiming Ha (ed.), *US-China Cooperation in a Changing Global Economy* (Washington, DC: Peterson Institute for International Economics, 2017), pp. 92–93, <https://piie.com/system/files/documents/piieb17-1.pdf>.

Figure 6: Bureau of Economic Analysis (BEA) and Rhodium Group (RG) Data on Annual Chinese FDI Flows to United States: 2005-2017 (\$ in Millions)



Source: Bureau of Economic Analysis and the Rhodium Group
 Note: BEA and RG methodologies for measuring FDI differ significantly

Another important tool for enhancing reciprocity would be a bilateral investment treaty. There is a correlation between trade and FDI. As an OECD study explained, “As trade barriers have fallen over the past two decades in most parts of the world and as intra-firm trade between countries have increased, a strong relationship has been observed between foreign trade and investment flows, including in Asia.”⁵³

For the United States and China, two of the world’s largest markets, there are efficiencies in producing, selling, and exporting in each other’s markets. This helps explain the substantial amount of US FDI in China (\$92.5 billion) and Chinese FDI in the United States (\$58.1 billion).⁵⁴ To create inroads for US FDI in key sectors, including tech sectors, which Beijing has reserved for developing national champions—and to address

growing concerns about Chinese inward investment in the United States—a BIT could help rebuild trust and serve as a framework for reciprocity, also functioning as a means of indirectly expanding trade. For US firms, a BIT would provide better legal protections, more transparent dispute-settlement procedures, and, in theory, more equal treatment with Chinese firms. For China, a BIT could help facilitate reforms by opening protected sectors to competition.

The United States and China began negotiations on a BIT in 2008, but there was a large gap in the two countries’ “negative lists” (prohibited sectors). Talks continued in several phases through 2016, with modest progress. The Trump administration has been ambiguous about a BIT, but US Treasury Secretary Steven Mnuchin has indicated that “it is on our agenda,”

⁵³ Yann Duval, Trade and Investment Linkages and Policy Coordination: Lessons from Case Studies in Asian Developing Countries (Paris: OECD, 2008), <http://www.oecd.org/investment/globalforum/40300944.pdf>.

⁵⁴ Ibid., p. 23.

though he stressed that the administration wanted to first achieve some market openings in China.⁵⁵ Xi's Boao Forum pledge to further revise China's "negative list" appears a possible opening, which the Trump administration would be wise to test. But, in the current US political climate, China would likely need to demonstrate new openings for US investment before Congress's skepticism of Chinese intent would diminish enough for US legislators to consider ratifying any BIT.

Beyond Bilateral: Global Governance Deficit of Emerging Technology

In any case, US-China relations will require a well-conceived blend of US direct pressure on China and multilateral coalition efforts to avoid similar market distortions and overcapacity in high-tech sectors like semiconductors, robotics, or autonomous vehicles, as Chinese preferential nationalist policies have caused in the cases of steel, aluminum, and solar panels. Moreover, there is also a risk of China creating its own standards and rules in emerging tech areas, such as 5G telecommunications, the Internet of Things, or Clustered Regularly Interspaced Short Palindromic Repeats (CRISPR) gene editing.

For example, in one of the more mature, pivotal, and fast-growing tech sectors, digital commerce—already more than 12 percent of total trade, and projected to grow to 25 percent by 2025—Chinese policies threaten to impede an important source of global growth.⁵⁶ E-commerce requires open cross-border flows of data and access to global clouds, which Beijing constrains. Businesses depend on digital networks to manage global supply chains, manufacture and distribute products, and provide an array of services. The US International Trade Commission says global e-commerce now totals \$28 trillion, increasing 44 percent over the past five years.⁵⁷ This dynamic sector is hindered by Chinese "cyber sovereignty" policies.

Beijing restricts information flows with its "Great Firewall" of censorship. As anyone who has tried to

use Gmail or read the *New York Times* online in China knows, the country has blocked the web presence of US tech firms Google and Facebook, as well as major US news media. Amazon access has been limited to just 1.3 percent of China's e-commerce, preventing it from competing with Chinese e-commerce giants like JD.com. More recently, China has banned US businesses from using virtual private networks (VPN) for secure communications, forcing them to use Chinese networks more vulnerable to hacking.⁵⁸

China's barriers to digital trade are detailed in the USTR annual report. It charges that China's 2017 Cybersecurity Law and 2015 National Security Law "severely restrict routine cross-border transfers of information and impose data localization requirements on companies in 'critical infrastructure sectors.'"⁵⁹ Beijing also restricts US firms' investment in clouds, which they can only own jointly with Chinese firms, which in turn impacts firms that supply cloud computing services. As discussed above, Beijing restricts VPNs, which are key to ensuring confidentiality of information transferred across borders. In addition, the USTR says that China's firewall blocks twelve of the top thirty global websites, and up to three thousand sites in total, obstructing potential US business.⁶⁰

The explosive growth of e-payments, digitally supplied products—from music, games, and books, to 3D-printed products, and soon, billions of devices connected via the IoT—underscores the importance of e-commerce to the global economy. Yet, digital commerce is a prime example of technology racing ahead of global governance. The world lacks a comprehensive international framework of trade rules governing digital commerce. Instead, there has been a rise in digital protectionism, and a Balkanization of the Internet.

China is not alone. The USTR cites data-localization requirements (forcing firms to keep data in the country of operations, rather than transfer or export it to larger databases) in Russia, Indonesia, and Brazil, among others. One study details data-localization measures in

55 Ian Talley, "US Treasury Secretary Mnuchin: China Bilateral Investment Treaty 'On Our Agenda,'" *Wall Street Journal*, June 6, 2017, <https://www.wsj.com/articles/u-s-treasury-secretary-mnuchin-china-bilateral-investment-treaty-on-our-agenda-1496774628>.

56 James Manyika, Susan Lund, Jacques Bughin, Jonathan Woetzel, Kalin Stamenov, and Dhruv Dhingra, *Digital Globalization: The New Era of Global Flows* (San Francisco: McKinsey Global Institute, 2016), <https://www.mckinsey.com/-/media/McKinsey/Business%20Functions/McKinsey%20Digital/Our%20Insights/Digital%20Globalization%20The%20new%20era%20of%20global%20flows/MGI-Digital-globalization-Executive-summary.ashx>.

57 Office of the US Trade Representative, "2018 Fact Sheet: Key Barriers to Digital Trade," March 2018, <https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2018/march/2018-fact-sheet-key-barriers-digital>.

58 Benjamin Haas, "China Moves to Block Internet VPNs from 2018," *Guardian*, July 11, 2017, <https://www.theguardian.com/world/2017/jul/11/china-moves-to-block-internet-vpns-from-2018>.

59 Office of the US Trade Representative, "2018 Fact Sheet: Key Barriers to Digital Trade."

60 Ibid.

thirty-one nations.⁶¹ In effect, differing approaches to privacy and national security (sometimes overlapping) on the Internet among the three major actors—the United States, EU, and China—are fostering three separate digital regimes.⁶² This problem, and the degree to which it may impede digital trade at great cost to all parties, is not sufficiently understood.

The digital realm is the most prominent example of a troubling governance deficit in regard to new and emerging technologies. There are no global rules for global data flows, which are critical to the future of world trade. The WTO Agreement on Trade-Related Aspects of Intellectual Property (TRIPS) and the General Agreement on Trade in Services (GATS) address some aspects of digital commerce.⁶³ But, there is a compelling need for political efforts to harmonize global rules and norms, or at least reduce the gaps between them. Looking at technologies on the horizon—such as 5G, AI/big data, robotics, and CRISPR/gene editing—global rules will be needed to safely and securely deploy such technologies.

In that technology landscape, the rules established for global data flows powering digital commerce may set a precedent, influencing the parameters of regional and global governance of the Fourth Industrial Revolution. That is why CPTPP, the first effort at a comprehensive set of rules and norms for digital commerce, is an important building block.

Although the United States has since rejected the Trans-Pacific Partnership (TPP, now revised as the CPTPP), it was instrumental in shaping the rules and norms the agreement codifies for electronic commerce. When the agreement enters into force (expected by the end of 2018), it will provide its members with nondiscriminatory treatment, free from customs duties on e-commerce. It bans forcing businesses to use or locate computer facilities in the territory of another country as a condition of doing business, and it prevents nations from requiring giving the host country source codes as a condition of inputs, or distribution or sales of products or services. CPTPP recognizes differing national approaches to protecting personal information, saying that member states need to create a mechanism to promote compatibility between different regimes.

The CPTPP is a somewhat abridged version of TPP; twenty-two provisions from the original TPP agreement relating to e-commerce, intellectual property, investment, dispute settlements, new medicine and biologics, and endangered species were all suspended under CPTPP. Each of these provisions was persistently pursued by the United States prior to its withdrawal, and was accepted by developing countries willing to forgo these interests in favor of greater access to the US market. President Trump has hinted on several occasions that the United States might consider returning to CPTPP; thus far, however, there has been no policy shift.

Nonetheless, these provisions are an important precedent for regional and global standards. Some of these measures are being considered in the renegotiation of NAFTA. At its December 2017 ministerial conference, the WTO formed a working group on digital commerce, which could build on the CPTPP standards to create global standards. Absent a concerted effort by the United States, EU, Japan, and other like-minded states, it is doubtful that the WTO would succeed in moving toward a new global treaty with robust standards to protect the free global data flows required to maximize the potential of digital commerce.

Conclusion: Is a Rules-Based Asia-Pacific Architecture Possible?

If current trends persist, the future of an inclusive regional and/or global trade architecture is highly problematic. The complexity of US-China economic relations and trade differences will require sustained negotiations to reach new understandings. It is unlikely that China will, in a bilateral context, accede to many of the US demands for the multitude of structural changes involving cybertheft, IPR protections, restrictions on FDI, and an end to “providing market-distorting subsidies that lead to excess capacity” in the ten industries targeted by Beijing’s MIC2025 plan.⁶⁴

Xi Jinping’s promises of reform in his Boao Forum speech echoed those he made at the 19th Party Congress in October 2017. Yet, China and its 150,000 state-owned enterprises (SOEs) remain some distance from transforming China’s investment-driven,

61 Alan Beattie, “Data Protectionism: The Growing Menace to Global Business,” *Financial Times*, May 13, 2018, <https://www.ft.com/content/6f0f41e4-47de-11e8-8ee8-cae73aab7ccb>.

62 Ibid.

63 For TRIPS, see World Trade Organization, “Trade-Related Aspects of Intellectual Property Rights (Unamended Version),” April 15, 1993, https://www.wto.org/english/docs_e/legal_e/27-trips_01_e.htm; For trade in services, see World Trade Organization, “General Agreement on Trade in Services,” https://www.wto.org/english/tratop_e/serv_e/gatsintr_e.htm.

64 Gabriel Wildau, “US Demands China Cut Trade Deficit by \$200bn,” *Financial Times*, May 4, 2018, <https://www.ft.com/content/d0eb3e4a-4f77-11e8-a7a9-37318e776bab>.

state-centric economy into one driven by consumption, services, and innovation.⁶⁵ Xi's speech at the 19th Party Congress was fundamentally contradictory, pledging China would be guided by "market-based allocation of resources," while also promising to "support state capital in becoming stronger."⁶⁶

It can be argued that it is in China's interest to allow reciprocal market access and fair global competition in the technology sectors that Xi has identified as drivers of Chinese economy. Certainly, if the price of Chinese current policies is that Chinese "big tech" (Alibaba, Baidu, Tencent, JD.com) substantially has its access to sell and invest globally curtailed, that may lead Beijing to rethink its "socialist market economy" ideology.

Moreover, absent foreign competition, the insular, inefficient, and heavily subsidized Chinese emerging tech industries are unlikely to be world-class industries. Moreover, such subsidies are not necessary. Over the past decade, there has been an explosion of venture capital (VC) in China, with tens of billions of dollars in government-backed funds and private capital. The numbers now rival Silicon Valley.⁶⁷ Market-based investment would make competitive Chinese firms and startups in AI and MIC2025 industries more likely to succeed.

Whether the Chinese Communist Party (CCP) can be persuaded that such policy changes are in China's best interest is another question. But, it will require the United States and other global players significantly raising the cost to China of sustaining the status quo. Some of the cost raising can be achieved in the process of rebalancing US-China bilateral economic relations. But, the United States is only 22 percent of the global economy, and China has millennia of experience with dividing rivals.

At the regional level, President Trump would be wise to follow through on his reconsideration of CPTPP. In addition to digital commerce, CPTPP is pioneering lofty standards for multilateral FTAs in other sectors, such as SOEs and government procurement. Modeling by PIIE projects that the income benefits to the CPTPP countries would be a collective gain of \$147 billion by 2030. In contrast, PIIE's simulation projected \$492 billion in

global income benefits had the United States remained party to TPP. No CPTPP nation gains from the absence of the United States, but the United States itself suffers the biggest net loss: the US economy goes from a projected gain of \$131 billion from participating in a TPP-12, to a \$2 billion loss as an outsider looking in on TPP-11.⁶⁸

At the global level, avoiding the worst case—a fragmented global trade regime—will require the sort of concerted US-EU-Japan efforts to push back and challenge Chinese policies that have begun in the WTO to be expanded to the ROK, Australia, and other OECD nations. This allied cooperation should expand its focus to building consensus for harmonizing standards and norms for 5G telecommunications, AI, CRISPR/gene editing, and other emerging technologies.

No less urgent, or important for a rules-based economic system, is the future of the WTO. Its long-term challenge—how to pursue future trade liberalization as a technology revolution unfolds, with a more multipolar set of stakeholders—is daunting enough. But, the WTO faces a quiet and more urgent crisis impacting its ability to function: uncertainty about the WTO's enforceable dispute-settlement mechanism, which is often viewed as the "crown jewel" of the global trade system. Detailed assessment is beyond the scope of this report, but a recent PIIE report offers an important critique and path forward.⁶⁹ Reforming WTO processes, and fixing the dispute mechanism, is in the common interest; otherwise, there is no legitimate referee for the world trade system.

Policy Recommendations

- US-China bilateral economic negotiations should seek agreement to reduce state subsidies, discriminatory administrative measures, coercive tech transfer, and other anticompetitive instruments to benefit emerging technology industries in MIC2025—and, as Xi pledges, to rely more on market-based allocation of resources.
- Once the new enhanced CFIUS legislation becomes law, Congress should closely monitor its implementation with quarterly hearings to as-

65 "China-7-State Owned Enterprises," Export.Gov, July 25, 2017, <https://www.export.gov/article?id=China-State-Owned-Enterprises>.

66 "Full Text of Xi Jinping's Report at 19th Communist Party of China National Congress," China Daily.

67 Phred Dvorak and Yasufumi Saito, "Silicon Valley Powered American Tech Dominance—Now It Has a Challenger," Wall Street Journal, April 12, 2018, <https://www.wsj.com/articles/silicon-valley-long-dominated-startup-funding-now-it-has-a-challenger-1523544804>.

68 Peter A. Petri, Michael G. Plummer, Shujiro Urata, and Fan Zhai, *Going It Alone in the Asia-Pacific: Regional Trade Agreements Without the United States* (Washington, DC: Peterson Institute for International Economics, 2017), <https://piie.com/system/files/documents/wp17-10.pdf>.

69 Tetyana Payosova, Gary Clyde Hufbauer, and Jeffrey J. Schott, *The Dispute Settlement Crisis in the World Trade Organization: Causes and Cures* (Washington, DC: Peterson Institute for International Economics, 2018), <https://piie.com/system/files/documents/pb18-5.pdf>.

assess its effectiveness on tightening restrictions on Chinese FDI in critical technologies. If there is evidence that harsher constraints on technology-sensitive FDI are needed, the Congress should either revise the law or press the administration to take use International Emergency Economic Powers Act (IEEPA), to take executive action. This would provide leverage to demand reciprocity and, perhaps, momentum toward a BIT. The administration should restrict cross-border tech transfer to Chinese entities or US-China joint ventures.

- The United States should restrict access of Chinese state-owned entities to US capital markets, for both equity and debt.
- The United States should restrict Chinese investment from any SOE or private firm that has violated intellectual property norms (a WTO-compatible policy).
- NOTE: All of the above recommendations are designed to create pressure for reciprocal US-China trade and investment standards, and should be reconsidered if and when China alters its policies and balance is achieved.
- The United States and EU should immediately begin a dialogue on harmonizing US views and data policies with the EU's General Data Protection Regulation (GDPR).
- The United States should lead an initiative in the WTO digital commerce working group to build consensus for global e-commerce.
- The United States should build on TPP digital commerce provisions to globalize a WTO sector-specific agreement, building on the Information Technology Agreement (ITA) and Trade in Services Agreement (TISA) accords.
- The United States should consider rejoining CPTPP, but also pursue bilateral and multilateral regional agreements that create high standards for new technologies. In addition, the United States should restart Transatlantic Trade and Investment Partnership (TTIP) negotiations with the EU. Together, these regional accords would account for more than 60 percent of the global economy, and enhance US/allied leverage to set global standards and norms for new technologies, as well as trade and investment regimes.
- Recent Group of Seven (G7) ministerial meetings on innovation should serve as a foundation for the G7 and the Group of Twenty (G20) to prioritize efforts to coordinate market-based responses to Chinese trade and industrial policies.⁷⁰
- The United States, EU, Japan, Republic of Korea, and Australia should form a coalition to challenge China's predatory industrial policies—in regional fora such as the Asia-Pacific Economic Cooperation (APEC) forum, in the G20, and also in filing formal sector-specific WTO complaints.
- The G20 should form an ongoing working group on governance of trade and investment in emerging technologies, and their social and economic impact on the future of work.
- The United States should call for an emergency WTO ministerial session to negotiate reforms of the WTO dispute-settlement mechanism. The G7 should also focus on shaping a consensus to reform the WTO and its dispute-settlement mechanism.

⁷⁰ Group of Seven Innovation Ministers, "G7 Innovation Ministers' Statement on Stimulating Innovation," May 2018, <https://g7.gc.ca/en/g7-presidency/themes/preparing-jobs-future/g7-ministerial-meeting/chairs-summary/annex-c>.

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