The other Trump trade war with China

Blog post by Senior Director Stephen Adams, 17 April 2018

The Trump administration's threat of 25% tariffs on $50bn of Chinese imports to the United States has inevitably dominated coverage of the President's decision to escalate a long-standing irritation with Chinese approaches to US inward investment into a full-blown trade dispute. But there are three legs to the US review of Chinese practice under Section 301 of the 1974 Trade Act, and tariffs are only one.

The second is a legal challenge to China at the WTO. The third is the instruction for a US Treasury review of US investment frameworks that will dovetail with existing Congressional efforts. Trump may yet back down on Chinese goods. There may be less incentive to back down on inbound Chinese capital, or even outbound US capital in China. The result may well be a more enduring legacy than the threatened skirmish on tariffs and goods.

As part of the Trump response under Section 301, the US Treasury has been instructed to review the freedom of capital 'directed or facilitated in China' in the US, in industries or technologies deemed important to the US. There has been some suggestion that the administration might invoke the 1977 International Emergency Economic Powers Act (IEEPA), which grants the White House wide-ranging power to restrict foreign investment in the US on national security grounds. The wording of the 301 order refers to existing statutory authority, and the IEEPA is one obvious place to locate this.

The administration's approach would most likely be to expand the remit of the existing Committee on Foreign Investment in the United States (CFIUS). One obvious route would be to give the committee new powers of scrutiny beyond its current scope of changes in control of US entities, expanding this into Chinese stakes of any kind, and potentially US joint ventures in China, where these are subject to the kinds of technology licensing arrangements the US has criticised in its 301 diagnosis. To be sure, this would be an extreme interpretation of the 1977 IEEPA, which refers to 'unusual and extraordinary threat[s]' to US national security. But that is unlikely to deter this administration, which now has form in imaginative interpretations of national security provisions.

Unlike on tariffs, the White House already has a Congressional base for action on investment. The draft 2017 Foreign Investment Risk Review Modernization Act (FIRRMA) and the 2018 Export Control Regulation Act are already on the ground the President wants to occupy. The former seeks to expand the CFIUS remit, the latter to expand the scope of the current export control regime for dual use technologies. Both are bipartisan and likely to pass in some form, either separately or as a single combined piece of legislation. In principle, the administration could use the 301 process to encourage both bills over the line in a robust form. Or it could simply overtake them via the use of statutory powers.

There is some reason to suspect this might be the more enduring impact of the current 301 process. Persevering with tariffs on Chinese goods at the end of next month would pit the administration publicly against Congress and much of US business, and trigger a Chinese tariff response targeted for political effect. The Chinese may yet provide enough in apparent concessions to allow the administration to back off.

Conversely, on the investment protection framework, the White House has implicit congressional backing for a major shift in the US's approach to investment and technology licensing (from China and anywhere else). This comes with fewer of the political collateral problems of potentially higher prices in Walmart or export challenges for US farmers. Chinese retaliation remains a potential problem, but this will be in the inner workings of the Chinese licensing regime or the suspension of not-yet-implemented relaxations to the Chinese joint venture rules. None of this has the political salience of a tariffs.

One interesting question this might raise is what happens to Chinese outbound investment deflected from the US by a stricter regime? At one level, it could imply more demand for opportunities in jurisdictions like the EU. However, it is no less likely that a tougher US approach to investment screening encourages some politicians in the EU to argue for a similarly robust approach to Chinese acquisition and technology transfer. The EU's current rumbling debate on investment screening suggests that this is one area where some EU politicians and policymakers would be willing to follow the US into a cold war on Chinese capital, even where they might baulk on a hot one on goods.

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