

THE BROOKINGS INSTITUTION
Dollar & Sense Podcast
Wendy Cutler on how to enforce a US-China trade deal
March 4, 2019

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(MUSIC)

DOLLAR: Hi I'm David Dollar, host of the Brookings trade podcast "Dollar & Sense." Today my guest is Wendy Cutler. Wendy is vice president of the Asia Society Policy Institute. Before taking up that post in 2015, she worked almost three decades for the United States Trade Representative Office working on the Trans-Pacific Partnership, U.S.-Korea Free Trade Agreement, negotiating with China over many, many years.

Welcome to our show, Wendy.

CUTLER: Thank you, David.

DOLLAR: She's the perfect person to talk about this week's issue which is the final negotiations between the U.S. and China on some kind of trade agreement. And we particularly want to get into the issue of enforcement.

The president's been encouraging about reaching an agreement, USTR Leitheiser was saying there are still important structural issues that are being negotiated, and there's the critical issue of enforcement. So that's really what we're going to talk about. And let me just start by asking, Wendy, what are some of the main structural issues that we're dealing with concerning China?

CUTLER: Well, thank you. And I think you're correct that this negotiation is getting into the home stretch and not surprisingly these so-called structural issues and enforcement issues are proving the most difficult.

With respect to the structural issues, I know in previous podcasts you've talked a lot about forced technology transfer and IPR so maybe I can just focus on a few of the other issues. One is the issue of state-owned enterprises, and that's very closely associated with the issue of subsidies. And here, it's really an issue of a level playing field. And frankly, can our companies—private companies—how do they compete against companies from China which are government-owned, backed, and really don't compete on a level playing field.

DOLLAR: Now I know that in the Trans-Pacific Partnership with which you were involved there's a chapter on state enterprises. Does that give us some guidance about what we'd be looking for in terms of state enterprise reform or in China changing its trade practices vis a vis state enterprises? What do we really want?

CUTLER: Absolutely. I think the state-owned enterprise chapter of TPP, which is now in force in CPTPP without us is very instructive with respect to this issue of state-owned enterprises. What that chapter says—it doesn't say, you know, you have to eliminate all your state-owned enterprises—but it recognizes that some state-owned enterprises are legitimate. They provide public functions. But it's state-owned enterprises that really operate in the commercial space and need to be disciplined, and they need to be disciplined with the whole idea of having a level playing field created. In other words, they need to be limited with respect to the subsidies and other financial assistance and financial support they get from the government. There needs to be more transparency, more reporting requirements so people know more about these entities and their backing and control by the government. So those are the types of disciplines that the CPTPP agreement includes. And I think in many respects, it provides a lot of useful guidance for trying to discipline Chinese practices in these areas.

DOLLAR: Right, as you say the U.S. dropped out of the Trans-Pacific Partnership. China was never one of the negotiators, but I would note that Vietnam is one of the members. There's been a lot of attention on Vietnam this week because of the summit there. So it'll be interesting to see if Vietnam can meet the standards on state enterprises because that's another mixed economy with a communist government.

CUTLER: Exactly. And for Vietnam this was a very tough issue for them, but they were able to agree to high standards in this area. But there was also an annex which I think could also be instructive vis a vis China which allowed each country to take a limited number of exceptions or have a number of years to phase in these provisions for specific state-owned enterprises. So I think that contract is also very informative for U.S.-China negotiations.

DOLLAR: Now another structural issue that we're discussing with China is the more general issue of intellectual property rights protection—how to protect property rights. We're concerned about our firms, other international firms, but it's a more general issue. So in that area, what do we really look for from China and what is realistic?

CUTLER: I think overall we want a very strong IPR regime. I think it's less on the protection side at this point and more on the enforcement side. There's been...through the years China has agreed to a lot of obligations on intellectual property protection, both when they join the WTO but in

subsequent discussions with the U.S. government and others, but it's really the need to ensure that nationwide they are respecting and enforcing the obligations they've undertaken and that there are high penalties for infractions. Because of the penalties are low, then a lot of companies and other entities in China figure "let's go ahead and just violate who cares will pay this low penalty." But if the penalties are high and they serve as a deterrent, that goes a long way in creating and a strong IPR regime.

I would also note, and this was my experience in negotiating with Japan and Korea as well, that over time some of the biggest IPR violators become some of the strongest IPR partners. And that isn't because of U.S. pressure, it's because of their own domestic needs. As they have more and more innovative companies domestically, it's in their own interest have a strong IPR regime. And I think in some respects we're beginning to see a convergence of interests between the United States and China here. So I think we can expect a pretty robust section in an upcoming trade agreement on IPR. The one area I would just underscore where I think China has a lot further to go in the IPR area is the area of trade secrets. And I know they have a law now but that law is woefully inadequate. It needs to be updated. It needs to have stronger penalties. And China needs to do a much better job in enforcing and making sure that the rights of trade secrets—including trade secrets by foreign companies—are respected and not violated.

DOLLAR: I think all of those are very important points. China has set up a series of intellectual property rights courts mostly adjudicating cases among Chinese. So, as you indicate, as they become a more innovative economy, you're going to have demand for this. But as you say the penalties are rather weak. So trying to get much more serious enforcement and honest penalties that definitely seems like the next agenda.

CUTLER: Yeah.

DOLLAR: So maybe just briefly on forced technology transfer, which I think is probably the third key structural issue, what do we really want China to do?

CUTLER: Well there, we just want them to stop that practice, and I think it's a legitimate request. Our companies should not be asked to turn over their IPR, their source codes, their trade secrets, [or] other proprietary information as a condition for doing business in China. While China has largely to date used its investment joint venture requirements to facilitate this practice, I think it

would be shortsighted of the administration to just solve this issue in the context of investment restrictions.

I think they really need a broad commitment from China that this practice will stop, it will stop vis a vis any investment conditions, but also any conditions of doing business in China. And we're not alone in having this concern. Other countries have the same concerns here, and I think it's valid and I think it's a practice that really needs to be addressed.

DOLLAR: So, I think we have most of the key issues on the table and some prospect of making progress. China is gradually reforming and we have some prospect of negotiating a trade agreement in which there's further progress. So, let's turn to the issue of enforcement. Why is enforcement so important and how would we be enforcing this? Is this really a legally binding agreement? Is this like a treaty? Is it going to go to Congress? I've been dying to ask you these questions.

CUTLER: I think the president and Ambassador Lighthizer had a very public discussion on whether the agreement is binding or not. The issue of enforcement it's just key because it's one thing for a country to say they're going to do X, Y, and Z, but there needs to be follow through and you need to make sure that any country, including China, is actually implementing according to the timelines agreed upon what they said they would do. And I think with respect to China it's even more important because the administration, and I think with some validity, has been critical of previous administrations for not emphasizing the enforcement aspect of these deals. And so this would be an important way for the administration to really distinguish any deal with China from the deals that they criticize with respect to previous administrations.

But the issue of enforcement is a really, really difficult issue. I see it, when I think about it, I think there's several aspects to it. One is the process. The second is what are you what are you assessing. And the third is what are the penalties.

With respect to the process, Ambassador Lighthizer this week did share with the Ways and Means Committee an elaborate set of meetings at different levels of the government. The way I understand it I think that it's safe to say that there'll be at least probably 18 or so meetings of U.S. government and Chinese officials on enforcement matters in any given year. That's a lot of meetings. And meetings are OK, but that's not the end of the story—that's the process.

But what do you do when you sit down at these meetings? And I think where the administration needs to be realistic, that if they're depending on companies to come forward with their problems that then can be raised with China, and China when address those problems, I think they're going to encounter a lot of problems because my experience is—particularly when it comes to China—companies are pretty shy to bring their problems to the USTR if they know those problems are going to be publicly shared with their name with the Chinese. There's a great fear of retribution. And so I think that any enforcement mechanism, it needs to include the input from companies, but it's also going to require a lot of resources and monitoring by U.S. government officials across a lot of government agencies and our embassy in Beijing and our consulates all around China.

DOLLAR: Perhaps you could talk a little bit about enforcement in some of our other agreements like...well we didn't stay in the Trans-Pacific Partnership but we negotiated complicated enforcement or the Korea Free Trade Agreement whichever you want to reference, but what do we normally do for enforcement in these formal agreements?

CUTLER: So, in the WTO, and in our free trade agreements, we typically rely on what I would call dispute settlement panels where a panel of independent panelists are brought together, they look at the facts of the case, and they make a pronouncement. They make a decision and that decision needs to be implemented by the party found in violation of the finding.

In Korea, particularly with respect to the automotive sector which was so sensitive, we included a special enforcement mechanism for autos, and the idea here was that we wanted to make sure that Korea would live up to its auto obligations and so we agreed on what we call a snapback of tariffs. And so if Korea was found in violation of any automotive commitments under the agreement the 2.5 percent tariff would be reinstated against Korea. And that served as, I think, an important deterrent.

With Japan through the years we tried a lot of different things on enforcement and some of those ideas are being discussed now. One, and this is one of the first agreements I work worked on at USTR, was the U.S. Japan semiconductor agreement where we basically said: "Look, you do whatever you need. We don't want to sit down with you and go through whether you're living up to this obligation or that obligation—we want 20 percent market share of your market." And so, our

enforcement mechanism was basically “is Japan...are they moving towards that 20 percent goal?”

DOLLAR: Right, so in general economists are not that crazy with these numerical targets, but let me just say that I am a practical economist.

CUTLER: Okay.

DOLLAR: And I think in dealing with China it definitely makes sense to put a lot of emphasis on: What are the laws and regulations [and] are they implementing that –we have evidence from companies that they are not. But, also, looking at the outcome which is “do we get X percent of the market” because they're allegedly open in a lot of financial services areas already, but foreign firms have less than 1 percent of the market. That can't be right. That can't really be open. So I do think we have to look at a combination of what are the actual results and then what are their regulations and laws. And I don't see that we can just rely on one of those.

CUTLER: And I couldn't agree more. And that's, you know in my mind, that's kind of the second aspect of any enforcement mechanism with China. What are you evaluating? What are you assessing? Is it, are they just benchmarks and whether China going forward with implementing a law and going out with public comment, or do you actually want to see outcomes results in the marketplace? And I totally agree with you that that second aspect is very important.

The other aspect, and the enforcement mechanism which I'm sure is probably extremely controversial, is what are the potential penalties if it's found that China isn't living up to its obligation or there are no real discernible outcomes in the market. And here, I'm sure the United States is insisting that it reserve its right to take unilateral actions should it find that China is not living up to its obligations.

I have to believe that China is opposing that and would prefer either some kind of joint assessment or having some independent panelist make a decision on violations. And, you know when you get to the issue of penalties, the other issue is what do you do with the tariffs in place now? We have tariffs on imports of 250 billion dollars worth of Chinese imports. My understanding is China is pushing hard for all of the existing tariffs to be lifted, but I think if you're Ambassador Lighthizer you would probably prefer keeping those tariffs in place, lifting them over time as China demonstrates that it's living up to its obligations. And so, they're going to have to figure out how to settle that issue. This may be an issue that actually is decided by the two leaders when they meet

in Mar-a-Lago. I don't think it's an either-or decision. I think you can lift some of the existing tariffs but also let some others phase out. But I think this whole issue of tariffs, what to do with existing tariffs, is an extremely important issue and I'm sure it's one of the last issues that will be resolved.

DOLLAR: From the negotiator point of view, you know, it makes sense to leave some of the tariffs in place or have the ability to snap back as you've described it. From an economist's point of view, we lose a lot of benefit of free trade if there's just uncertainty. So maybe a lot of the tariffs are removed, but if there is this uncertainty that they could come back relatively quickly then American firms are not really going to invest in selling into the Chinese market. It's going to be risky.

CUTLER: Yeah, and that will be an important consideration. But as a negotiator, my view is that the minute you lift them it's a lot harder to reimpose them, and that you have a lot more leverage against another country in ensuring full implementation and they have them huge incentive to making sure they're living up to every provision of the agreement if they know that tariffs will be lifted as they make progress. But I understand your viewpoint and I think both interests will need to be balanced.

DOLLAR: Let's broaden out the issue of enforcement a little bit to think about how we can work with partners to try to bring about some of these changes in China. A lot of our key partners – the Europeans, Japan, South Korea—they have similar concerns. All of the structural issues we are talking about. How can we work with them? Because what we've really been talking about mostly is a bilateral negotiation between the U.S. and China.

CUTLER: Yes. And my view is once we reach this bilateral deal, I really think that emphasis should shift more to working with other countries in addressing the kind of issues that China presents to the international trading system. And in fact, in the Asia Society Policy Institute we are drafting a paper with some concrete suggestions here on different ideas and multilateral approaches.

First, I would say I applaud Ambassador Lighthizer, Japanese Trade Minister Sekō, and EU Commissioner Malmström. The EU, Japan, and the US are working together on a trilateral initiative focused on practices like industrial subsidies, like state owned enterprises, like forced technology transfer, and are actually working on not only identifying the problems but coming up with concrete proposals. But then the question is what do you do with these proposals? Ideally you could bring

them to the World Trade Organization and the WTO rules could be updated to address the kinds of challenges that China's state-led economic model poses for the multilateral trading system, but I think we all need to be realistic. The WTO doesn't have a really good track record in negotiating deals particularly on issues as complex as this. There are 164 members, they operate by consensus, and you can even see a scenario where China agrees and some other country says "no, we don't want to be any part of this" and they can block the whole agreement. And so, I think countries are going to need to be creative on the best way to kind of advance plurilateral and multilateral work in these areas. And my view is, like the TPP model, the best way to move forward at this time is to work with a group of like-minded countries, come up with rules, come up with new standards and disciplines, and then over time expand the circle and bring other countries in including China. I think putting all your eggs in the WTO basket is doomed for failure.

DOLLAR: Right, I always thought the logic of negotiating the Trans-Pacific Partnership was to get a like-minded group in Asia-Pacific dealing with new issues like data and IPR protection services investment. And then if we could have gotten a similar consistent agreement across the Atlantic, then you have most of the developed world plus certain like-minded developing countries setting up essentially a new set of rules and regulations. And I don't think it will be easy to get China into that, but the incentive would have been there for China to aspire to be part of that.

CUTLER: I think the issue of state-owned enterprises in particular might be really ripe for a plurilateral agreement, and the reason I say this is you have, again, the 11 members of the CPTPP that have basically agreed on the TPP disciplines; the U.S. has agreed on an SOE chapter in the recently concluded USMCA which largely mirror and frankly improve in some ways and update the TPP chapter; and then the Japan-EU deal also has an SEO chapter. So that's a pretty solid group of countries that have very had to agree to similar rules in this area. And so, I think one of the ideas we'll be putting forward in our paper that we plan to release shortly would be: Let's look at a plurilateral on state owned enterprises. And if the administration is allergic to TPP, why not pick one issue and try that plurilateral approach and see if that can help really raise the standards here and bring China in as well at some point.

DOLLAR: Any chance the administration's allergy toward TPP might change? Because just listening to us talk, in dealing with China—or you mention the revised NAFTA, the USMCA—the

U.S. has borrowed in chapters from TPP pretty much wholesale in order to move quickly with Mexico, Canada, other partners. So, if we're taking whole chapters out of TPP, why wouldn't we just rejoin?

CUTLER: Yeah, kind of makes sense does it? I'm not optimistic about this administration rejoining TPP, but to the extent that they...in their bilateral approach they're lifting TPP disciplines and putting them into those agreements. I think that's positive, and I think it shows an appreciation by the administration of the good work that previous administrations did in this area.

DOLLAR: You expressed some skepticism about the WTO policing a lot of these issues.

CUTLER: Negotiating these issues.

DOLLAR: Yeah, negotiating some new agreement and they can't discipline them if they don't have a new agreement. So, I share that sentiment, but I do notice that we just got a WTO decision in favor of the United States against Chinese grain subsidies. It's probably a simpler issue than their industrial subsidies, but I thought that was promising.

CUTLER: Exactly. I think that, you know, when you look at the Obama administration, China enforcement was very important to the Obama administration, but the route they chose was mainly going through WTO dispute settlement. And a lot of victories were achieved with respect to different issues—agriculture, movies, cars et cetera—and so the WTO dispute settlement mechanism is useful. And you're correct, we just announced victory in a very important case in the agriculture sector. So I would hope that when the administration finds issues that it thinks could go through the WTO dispute settlement that they don't rule out using that multilateral mechanism. And in fact, when they announced this Section 301 investigation and the findings from it earlier—or, now last year—they also initiated a case against China's licensing practices in the IPR area.

But at the same time, let's just be honest the dispute settlement system is kind of under attack and may grind to a screeching halt by the end of this year due to the administration's concerns with the appellate body and its continued insistence on not approving any new judges for the appellate body. So putting your eggs in the WTO basket vis a vis any country is probably not the best avenue right now until we know what the outcome will be of the discussions this year.

DOLLAR: Right, so last question: Putting together everything we've talked about, are you optimistic that we'll actually get a trade deal with China? And, some months down the road will we

look back and think it was a good trade deal with China?

CUTLER: I'm optimistic we'll get a deal with China and from what I understand is under discussion I think the prospects of really achieving a meaningful deal are high. But I would caution anyone: No trade deal is perfect. And I assume now the administration is beginning to realize that some of their objectives are just not going to be achieved. And so the key will be is when you—add in any trade negotiation you have to decide is—at what point do you need to just kind of conclude the deal, you've attained as much as you can, you have a good enforcement mechanism, but you also recognize that this isn't going to solve all the problems. We're going to continue to have problems, but I think what's really important is now we're going to have a lot of communication between both governments going forward. And so, while this trade deal could be very meaningful, I think that the trade issues between the United States and China, just given the size of their trading relationship as well as the different economic systems, we're going to see a lot of problems going forward. But hopefully through these different mechanisms we'll be able to deal with them in a less confrontational way. I'm hopeful that the days of tit for tat tariffs are over. I think the administration, they followed that approach, they caught China's attention, they got China to the negotiating table, but I don't think that's a good strategy for going forward—relying on tariffs at this point.

DOLLAR: Wendy Cutler thank you for your very balanced and thoughtful remarks. I really like the way you concluded. We have a good chance of making some substantial progress, but we're not going to solve all these issues. It's great to have your analysis because these issues are probably going to be with us for a long time to come.

CUTLER: Thank you. It's my pleasure.

DOLLAR: Thanks a lot.

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