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Former USTR Charlene Barshefsky on the obstacles to a US-China trade deal
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(MUSIC)

DOLLAR: Hi, I'm David Dollar, host of The Brookings trade podcast, "Dollar & Sense." Today, I'm talking with Charlene Barshefsky, former U.S. trade representative and a partner in the law firm Wilbur Hale. We're going to talk about China's membership in the World Trade Organization and U.S.-China trade relations. Welcome to the show, Charlene.

BARSHEFSKY: It's a pleasure to be here. Thank you.

DOLLAR: So, you were the United States trade representative when the U.S. and China negotiated the terms under which China could join the WTO. It's common in Washington now to argue that it was a mistake to let China into the WTO. Surely, it has to be more complicated than that. So, I'd like us to try to break down what are some of the positives and what are some of the negatives. Let's start with the positives since people tend to forget those these days. So, what's good about China being in the WTO?

BARSHEFSKY: Well, as you know, China's period of reform and opening on the economic side began under Deng Xiaoping in 1978. And from 1978, well through China's WTO accession, China continued on the road of economic reform and opening. And if you look today, for example, China is the world's second-largest importer, right behind the United States. That would never have happened without WTO. In other words, China became a world market. China also had access to the world's markets. But bear in mind it already had that before WTO, as most countries let China into their markets -- indeed as did the United States -- applying to China the same rates of tariffs we apply to our allies, for the most part. So, China had access to the world's markets, but the world did not have access to China's market. And it is that economic reform and opening, as accelerated and vastly deepened by WTO accession, that has made China the world's second-largest importer.

What has happened? Well, beginning in I would say in about 2006-2007 under the administration of President Hu Jintao, China, rather than continue on a road toward economic convergence with a Western model, began to diverge from market economics (which is to say the Western model). And that divergence, which began under Hu Jintao, has accelerated under Xi Jinping. But it's all of the same type of activity, which is to say the increase in power and financial wealth of the state-owned enterprises, which, in earlier years of China's WTO accession had been vastly cut down in size.

Now, we see the resurgence of state enterprises, the creation of champion companies in China (among which are Huawei, which has been in the press so much), the provision by China of massive subsidies to state-led or state-invested enterprises, discrimination against foreign

companies -- rather gingerly at first, but over time, and certainly now, has increased very substantially -- and a host of other practices, including forced technology transfer, the theft of intellectual property, so on and so forth. And under Xi Jinping, of course, this mode of economic behavior has been given a name and the name revolves around the notion of the "China Dream" -- the emergence, the great emergence of the Chinese state, of the Chinese people back to the center where it historically had been (in an economic sense, and in part in a cultural sense, but largely economic sense).

So, this presents a substantial challenge to the United States. The shame of it, if we can use that word, is that the United States missed many opportunities to enforce the WTO agreement against China. So, in that agreement, there are, for example, three provisions that are especially pertinent today. One is a prohibition against forced technology transfer. Remarkably, neither George W. Bush, nor Obama nor Trump have ever sued China on that provision. This is an incredible lapse. There were provisions about the conduct of state enterprises and the fact that the government could not directly or indirectly interfere in the commercial activities of state enterprises. Again, neither the Bush, Obama nor Trump administrations ever sued China on the basis of their provision. And last, of course, was a special anti-surge provision, whose terms existed for 12 years after accession, which prevented China from disrupting the U.S. market. And if it did, with respect to its imports, the president of the United States was given carte blanche authority to do whatever the president deems necessary -- including, for example, the imposition of tariffs and so on, as we see today. But if it had been done under that provision, it not only would have been internationally legal, it would have barred China from retaliating against us. This provision was used only once in 12 years by President Obama in the case of market disruption to U.S. tire manufacturers. Other than that, it was never used and relief was repeatedly denied by George W. Bush.

So, these were tremendous opportunities and remain opportunities for enforcement which the U.S. did not take. And instead, the U.S. opted for a series of dialogues with China: Strategic Economic Dialogue, Strategic and Economic Dialogue, and Innovation (the ampersand in the Obama administration). And rather than these dialogues being a forum for resolution of issues, such as the ones I just mentioned, they became talk fests and the way in which China managed the United States, not the other way around. Again, opportunity lost.

So, between China's shift in policy and opportunity lost with respect to enforcement on the part of the U.S., in at least these examples, I think we see the situation we see today.

DOLLAR: So, if I understand you, the U.S. has put a lot of emphasis on bilateral discussions with China and now, trying to have bilateral negotiations, going through the WTO would have been a more multilateral approach. Could we have worked with our traditional allies -- Europe and Japan --- would they have supported us in those kind of actions?

BARSHEFSKY: I think they absolutely would have supported us, but I'm not sure anyone tried to persuade them to do so. Certainly not this administration, and prior administrations didn't utilize the WTO in the way in which I'm talking. The Obama administration, to its credit, did bring a number of enforcement actions against China under WTO but in very narrow areas, not with respect to these very substantial practices, like forced technology transfer, intellectual property theft.

In addition, it is unfortunate that the Trump administration hasn't used the WTO in a slightly different way with respect to enforcement -- and that is, there are provisions in the WTO that if the agreement entered into doesn't seem to be working to the advantage of the countries that let China into the WTO as they thought it would. And to the extent those countries believe China's accession has not yielded the promise or the results that one could reasonably have expected, they can bring an action in the WTO called Nullification and Impairment -- that's a technical term that says basically, China's actions have nullified and impaired the benefits that we, the U.S. and our allies, thought we would get from China's WTO accession and therefore, for example, we don't want to apply most favored nation treatment to China any longer or any one of a number of prayers for relief one might have. This would be a very substantial action. They're not easy to prove. But, if the U.S. acted with its allies, it would send a definitive kind of message to China, which is, "Hop on board. Go back to the direction you had been, which was on a convergent course, or suffer the withdrawal of trade privileges, not just from the U.S., but from your major trading partners."

DOLLAR: A common storyline in Washington is that the real structural shift, the real change, has been Xi Jinping becoming the leader and particularly, ending term limits. So, it looks like he can continue to rule for a long time.

You've written that the slowdown in reform started much earlier, and you just alluded to this a few moments ago. It seems to me the Global Financial Crisis was really the big structural shift, not Xi Jinping's election. This is quite important because if Xi Jinping is the problem, and if he is going to be there forever, then it seems unlikely that we'll be able to negotiate changes or, you know, China will shift. So, could you elaborate a little bit on this aspect of Chinese politics and how it affects the trade situation?

BARSHEFSKY: Well, let me let me start by just making a comment on the global financial crisis. I think it has been vastly underestimated the extent to which the financial crisis affected the perception of the United States by our trading partners and by China. What you saw during in 2008-2009 was a near synchronous decline in the economies of the United States, Japan and Europe. You saw the United States that appeared to have mismanaged its own financial house and mismanaged the global financial house, if you will, making what looked like an invulnerable United States into a vulnerable, not-nearly-as smart-as it-thought-it-was United States. And what China saw in that timeframe was a massive opening for it.

First of all, a change in its own thinking about the notion that the international institutions were inviolate and instead, you saw a China that recommended the creation of the Asia Infrastructure Investment Bank, which is sort of an analogue to the World Bank. It suggested an analogue to the IMF, and so on. It also embarked on a series of other initiatives, not the least of which most recently as Belt and Road. China saw a global system that was malfunctioning that had been led by the United States, which was the primary malefactor in its view, and saw an opportunity to step in and begin creating a more sinocentric environment, a friendlier to China environment. Which, by the way, was understandable, given that China had been I think treated poorly with respect to voting rights and the rule in the IMF in particular, which the U.S. did not rectify until it became too late. And so, you saw a China that was beginning to take a leadership role.

Xi Jinping changed the equation by becoming boastful about it. There had always been sort of the ethos in China, "hide and bide." Hide your capabilities, bide your time, keep your head down, low profile -- lest China be viewed as a threat. Xi Jinping decided the hide and bide era was over and became so boastful about China's accomplishments and China's plans, including Made in China 2025, that alarm bells went off across the United States and many allies. Not so much that the facts changed, because I think China's intention was already clear, but in the aggressive and almost hostile way China's aims were put quite anti-Western in tone, the notion that China would not interfere in the internal affairs of other countries and that, as the West was in decline, it was now center stage for the developing world. And of course, that formulation favors China drastically because it is the heir to the developing world. So, it has presented sort of a world view that helps to further its own individual aims, while being somewhat attractive to developing in other countries as the U.S. floundered around.

And of course, our recovery took 10 years. So, it was a long, long haul. Between 2007, 2008, 2009 and where we are today, of course, much more robust. That's good for the United States, for a host of reasons, obviously, and some concern to China. The U.S. has quite a bit of economic resilience now, perhaps some argue more than China does, making the tariff fight harder on China than the U.S., but it's hard on the U.S. nonetheless.

So, I do think the financial crisis was a pivot point for China -- for the articulation of its ambitions and the way in which it articulated those ambitions in a rather aggressive, almost hegemonic tone. So, that certainly is one substantial element, and the other element too is Xi Jinping and I think what he views as China's historic destiny. China was the center of the world at the center of the world for millennia, and it's only in the last five or six hundred years that China lost its lead. China became non-innovative, the Industrial Revolution came along. China missed it, remained poor, remained backward. And China is now in the process of catching up and doing it very, very rapidly. Xi Jinping has put an emphasis on the historic nature of these activities -- the historic nature of China's re-emergence, of China's rise, and puts it in both very prescriptive terms, but nonetheless with sort of the notion of great potential ahead for China. Something to reach for, something to shoot for.

So, the combination of the financial crisis, coupled with a leader like Xi Jinping, who puts economic activity in visionary and historic terms, is a powerful combination for China.

DOLLAR: I think your emphasis on the financial crisis is very important. As it was unfolding, I was living in Beijing, head of the World Bank program, and one of the things I did was -- I was invited to the Hubei Party School to lecture to the 500 top Communist Party officials from Hubei Province, which has about 100 million people, on the financial crisis and implications for China. During the questions, one man stood up and said he was the governor of a county that had millions of people and he said, "We used to think the U.S. was the model for everything, and now we don't know what to think."

Now, I was a little surprised. I wasn't aware the U.S. was the model for everything in China. But, we were talking about economics and he did mean it was the model for financial regulation, for a market economy, joining the WTO, all of these things, and it really threw China really big curve ball that we had such a devastating impact from that financial crisis.

BARSHEFSKY: It certainly threw Americans for a curveball, I'll tell you.

DOLLAR: Of course. So, let's talk a little bit about prospects for a trade deal between the U.S. and China. Given everything you were just saying, you know, it doesn't look like there's much negotiation going on right now, so we're not trying to look into a crystal ball about the next few

months. But over the next year or so, are there prospects for a trade deal? Can China actually change these practices that you've identified that are that are damaging to us?

BARSHEFSKY: Well, look, I think since the deal collapsed in May, there have been a series of escalations on both sides -- on the U.S. side and on the China side. On the U.S. side, of course, putting Huawei on the entity list, making it illegal to sell to Huawei, making it illegal for foreign companies to sell to Huawei. If what they're selling contains U.S. technology, it poses an existential threat to China's flagship and only multinational company that's been successful. So, this is a substantial escalation from China's point of view. Threatening tariffs of as much as 25 percent on the remaining 300 billion of Chinese trade with the United States is another escalation.

There have been a variety of other escalations. Most recently, now the further tightening of student visas and tightening of visas for scholars, which is really rather unfortunate, but is yet a further escalation. On the China side, of course, the U.S. put Huawei on the entities list. China is now going to create an entities list of its own, which will be far broader and far more opportunistically applied, I'm quite sure, than a U.S. list would be, but both are rather undesirable.

China has put out a spate of programs on the technology side, which frankly, have been years in the making. But they're rolling them all out now, furthering its cybersecurity, data security national security, product standards aims -- which is to say, more sinocentric with China having even greater rights to source code, to encryption keys, things of that sort with respect to foreign technology, and further rights to gain data from network service providers. It has sanctioned Ford for certain so-called anti-competitive practices in China and it issued a white paper, which I thought wasn't all that different from what they've been saying -- China's sovereignty is paramount and things of that sort. But what I thought was interesting about their white paper was that they translated it into eight languages, which suggests both that they want to regain the narrative on who did what to whom with respect to the deal that cratered, but also that they want to make clear that they are only responding to U.S. provocation. China didn't start this, China says, but rather are just responding to the U.S. Of course, the U.S. view would be that China absolutely started this by embarking on the practices that it did with respect to IP, tech transfer, subsidies and so on.

Can they come together? Well, I think in the long-term, trade war between the two countries doesn't favor either president. They both begin to look less competent than people might have thought they were, the hit on the economy grows over time, business uncertainty increases, investment stops, there's a slowdown. It's a little bit like a fiscal contraction in impact and that's going to be the case for both economies, not only because it gets harder for U.S.

exports to sell into China, but China's exports to the U.S. become more expensive and more difficult to afford and so on (if they can get in at all and if adequate substitutes are not available). So, it creates a very messy and undesirable situation, slowing both economies and therefore slowing global growth, which is what the IMF and World Bank I think are most concerned about at the present time.

So, will there be a deal? I think yes, there will be a deal at some point. Will it solve all the problems? I don't think it's possible to solve all the problems, but I think it's possible to make progress in some of these areas. For example, if you take away all joint venture requirements in China, and therefore the ability of the Chinese partner to siphon technology or intellectual property, you gain greater advantage in the China market and your intellectual property isn't fully protected, but more protected than it might have been. So, there are ways to make progress in these areas that I think are important.

And I think further, the single most important thing that the United States can do, if it wants to sort of tame what it views as the "China challenge," is to get our own house in order. Our R&D spending as a percent of GDP has fallen persistently since the actually the 1950s or 1960s. The United States infrastructure is falling apart. Our education system is lagging in the world, not just having to do with China, but the world. And there's so many other areas where the United States has done almost nothing for the past decade plus, perhaps two decades. That has to change if the United States is going to address the China challenge. If we don't maintain our competitiveness, if we don't maintain the best educated and most skilled workforce, we will lose -- regardless what China does, regardless what China agrees to. We will simply not keep up with a China that is hungry, that has tremendous internal talent, that is 1.4 billion people, and that has the scale and the capacity to deliver. So, the United States has to up its game and I see no evidence at this point that we're doing so.

DOLLAR: I was in Shanghai and Beijing over the last couple of weeks, and a lot of the economists I talked to in China recognize that these Chinese practices are actually damaging to their productivity growth and their economy. So, there is a constituency -- about 70 percent of foreign investment into China now is not in joint venture, it's in 100 percent foreign owned. So, they've demonstrated they can do that in many sectors and asking them to do that in all sectors is really quite reasonable.

BARSHEFSKY: I think that that's right. I think further, you know, China is at risk, as you know, of seeing its supply chains disintermediated because of USA Action with companies deciding to move some or part or all of their supply chains out of China, or at least removing China as the

hub, the main assembler, for example. That would have quite devastating consequences because certainly, over 50 percent of China's exports to the United States are from foreign invested enterprises, which is to say largely their supply chains. And if that leaves, you have very substantial export risk from China. And while China's internal economy has grown in terms of consumption, certainly China is still also export-dependent, so it can ill-afford to see these very lucrative supply chains move out of China and into potentially competitive countries in certain areas. So, that's something else that China needs to think about, and U.S. companies always have. There's a lever to use to get better treatment in China.

DOLLAR: So, last question Charlene, there are people in Washington now arguing the U.S. should decouple from China, but we can't really get along these two very, very different systems. What do you think about this idea?

BARSHEFSKY: I don't know what decoupling means but I'm quite sure that the administration has no plan whatsoever for what it actually means in practice, what it would lead to, and whether, if the U.S. wanted to decouple, it could -- whether it would be sustainable if it did. I don't think there's any thought given to this at all. There's certainly no plan. There is no long-term strategic vision for the role of China and the United States in the world. I think harder-liners would like to see the Chinese economy slowed substantially, become more fragile, perhaps in their wildest imagination collapse. Something of that sort. That sounds rather apocalyptic, but I think there is at least some strain of authority of view in that direction.

Versus others who see decoupling more as a catchall phrase to really describe what the U.S. would like to do solely with respect to certain technologies. Which is to say the United States has to pay more attention to our own internal security and our national security needs, and therefore, there will be certain applications for which Chinese technology is completely unacceptable and certain networks, for example 5G, in which the US would rather not have much in the way of Chinese, if any, technology. But there are many areas, handsets for example, where we sell to China, China sells here, so on and so forth. One could imagine a system of mutual deterrence -- you use your handset to spy on us, we'll use our handsets to spy on you. And so why don't we just cut it out and go in some different direction?

So, there are some who view what I think the administration is beginning to do on Huawei, for example -- although there they're using the media acts, which I think is unfortunate -- but trying to do with respect to Huawei or other Chinese technology, just to cabin in a bit so that U.S. domestic and national security is better protected. But as for a full decoupling, I'm not sure what it

means, what it portends, what it would lead to and whether the U.S. would ever win. And my own view is if you want to start a war, you better make sure you're going to win it.

DOLLAR: We've been talking to Charlene Barshefsky, former United States trade representative. You've given us a lot of insight about the past, China's joining the WTO and its trade practices, and also about the future -- how the United States can work better with China for mutual benefit. So, thank you very much, Charlene.

CHARLENE: My pleasure. Thank you so much.

DOLLAR: And thank you all for listening. "Dollar & Sense" is a part of the Brookings Podcast Network. It wouldn't be possible without the support of Shawn Dhar, Anna Newby, Fred Dews, Chris McKenna, Gaston Reboredo, Brennan Hoban, Camilo Ramirez, Emily Horne, and many more. If you like the show, please make sure to rate it and leave us a review. Send any questions or episode suggestions to bcp@brookings.edu.

And until next time, I'm David Dollar and this has been "Dollar & Sense."