

# ISSUE BRIEF

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## U.S. Needs to Address Chinese Trade Distortions, But Section 301 Is Not the Way

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The Trump Administration is taking on Beijing over years of complaints about the coerced transfer of technology from American companies. However, unilateral action under Section 301 of the Trade Act of 1974 risks a breakdown over trade with China. The collapse in trade with China could cause wide-reaching negative impacts for the American economy. Tariffs and sanctions on Chinese imports could also directly harm American consumers and violate America's commitments to the World Trade Organization (WTO), which was approved and implemented with broad bipartisan approval by Congress in 1994.

While the Administration and Congress should address threats to companies' proprietary information, the Administration must avoid a heavy-handed policy approach and instead stay true to core American values. The government must act to protect the one thing that makes trade and competition even possible: the protection of private property. Congress should authorize a whole-of-government approach to protecting the intellectual property (IP) rights of American companies and innovators, while causing no harm to the American economy.

### Competition in China

China is not a completely state-run economy. The opening of Chinese markets in 1978 has allowed China to grow into the cash cow it is today. Trade and competition enabled the population of those living in extreme poverty in China to almost disappear, dropping from 66 percent in 1990 to just 2 percent in 2013.<sup>1</sup> Over the past decade, e-commerce has exploded into a \$2.5 trillion market.<sup>2</sup> However, there are concerns that Chinese officials are increasingly suppressing competition.<sup>3</sup>

Domestic and foreign companies can still compete, albeit only in sectors where the Chinese Communist Party allows competition. Whatever complaints American companies have against Chinese market access, those same companies are still willing to give in to any number of Chinese demands just so long as they can access the growth potential of China's economy. Yet these restrictions are one of the reasons why China consistently ranks as a mostly unfree economy in the *Index of Economic Freedom*. The Chinese Communist Party is determined to continue supporting state champions by any means necessary. This includes limited competition but it also includes allowing or assisting in the theft of IP from the best companies in the world. For America, IP theft represents an almost \$600 billion annual loss.<sup>4</sup>

Currently, there is no agreement in Washington over how to respond to the requirements American firms face when trying to access Chinese markets. The U.S. has been working with the Chinese on issues like increased transparency by various government entities for years, but with little result. Hence the question: On an issue as important as IP

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theft, how can the U.S. do better at inducing change in Chinese behavior?

### **Punishing Theft**

As members of the WTO, the U.S. and China can dispute over the agreed Trade-Related Aspects of Intellectual Property Rights (TRIPS) which states that countries must treat American IP no less favorably than their own. The U.S. brought a TRIPS dispute against China in 2007 which was joined by a number of allies, including Canada, Japan, and Mexico. The dispute settled in favor of the U.S., with China needing to better enforce IP rights.<sup>5</sup> However, current U.S. Trade Representative (USTR) Robert Lighthizer is skeptical of the credibility of the WTO and is seeking an alternative response.<sup>6</sup>

The USTR is currently investigating Chinese commercial practices relating to technology transfer and IP; in addition, the USTR will investigate whether the Chinese government is “conducting or supporting unauthorized intrusions into U.S. commercial computer networks or cyber-enabled theft of IP, trade secrets, or confidential business information.”<sup>7</sup> The USTR and President, based on their findings, could then target specific sectors or industries in China with punitive tariffs through Section 301 of the Trade Act. Targeting specific bad actors with fines may be appropriate but broad tariffs under Section 301 may not be entity-specific enough and may not be the best method of deterring IP theft. The Department of Justice has indicted Chinese nationals for crimes of espionage in the past, but the U.S. has never sanctioned a Chinese company for cyber-enabled theft of IP or trade secrets.

### **Timing Is Everything**

Developing countries like China will naturally place higher value on protecting their (and other’s) property over time. At present, objections remain to the consistency of Chinese courts and their enforcement of IP rights. China has been on the Priority Watch List of the USTR’s annual report on intellectual property since the report launched in 1989. At face value, Chinese officials have tried already to adhere to international standards regarding IP protection. However, because of the incentives created by Chinese leadership—the demand for technological superiority and growth—theft by Chinese entities continues. The U.S. must assert that it is anti-theft, not anti-trade or anti-China.

The Administration will have to balance its policies for “America First”—or else risk the nation becoming “America Alone.” The U.S. should bring as many cases against China as warranted, and recruit allies to its side (the U.S. is far from alone in its concerns). Taking unilateral action not compliant with WTO obligations risks undermining potential support from other concerned parties, and giving the upper hand to the Chinese.

Congress must take the lead in establishing U.S. policy that guides China into becoming a responsible economic partner. To that end, Congress must:

- **Establish a new watch list in the Department of Commerce.** Congress should authorize the Department of Commerce to immediately begin tracking Chinese entities that steal or currently use known stolen American IP. This list should be

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1. The World Bank, “China Poverty Headcount Ratio at \$1.90 a Day (2011) (% of Population),” DataBank: Poverty and Equity, 1990 to 2016, <http://databank.worldbank.org/data/reports.aspx?source=poverty-and-equity> (accessed January 19, 2018).

2. Jake Spring and John Ruwitch, “China Targets \$5.7 Trillion in E-Commerce by 2020: Government,” Reuters, July 27, 2016, <https://www.reuters.com/article/us-china-economy-ecommerce/china-targets-5-7-trillion-in-e-commerce-by-2020-government-idUSKCN1070QD> (accessed January 19, 2018).

3. Derek Scissors, “Chinese Chains on Competition,” American Enterprise Institute, October 5, 2017, <http://www.aei.org/publication/chinese-chains-on-competition/> (accessed January 19, 2018).

4. Dennis C. Blair, Jon M. Huntsman Jr., Craig R. Barrett, Slade Gordon, William J. Lynn III, Deborah Wince-Smith, and Michael K. Young, “The Theft of American Intellectual Property: Reassessments of the Challenge and United States Policy,” The National Bureau of Asian Research, February 2017, p. 4, [http://ipcommission.org/report/IP\\_Commission\\_Report\\_Update\\_2017.pdf](http://ipcommission.org/report/IP_Commission_Report_Update_2017.pdf) (accessed January 19, 2018).

5. News release, “United States Wins WTO Dispute Over Deficiencies in China’s Intellectual Property Right Laws,” Office of the United States Trade Representative, January 26, 2009, <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2009/january/united-states-wins-wto-dispute-over-deficiencies-c> (accessed January 19, 2018).

6. Leslie Wroughton, “US Trade Envoy Says WTO Dispute Settlement Is ‘Deficient,’” Reuters, September 18, 2017, <https://www.reuters.com/article/us-trade-nafta-lighthizer/us-trade-envoy-says-wto-dispute-settlement-is-deficient-idUSKCN1BT205?il=0>, (accessed January 19, 2018).

7. *Federal Register*, Vol. 82, No. 163 (August 24, 2017), pp. 40213–40215.

updated frequently and, within 6 months, made public to both shame bad actors and empower American businesses and consumers.

- **Instruct the Department of Treasury to sanction those on the Commerce watch list.** Treasury should work with Commerce to identify and sanction Chinese companies and individuals on this watch list. To date, no Chinese companies have ever been sanctioned for cyber-enabled theft. Treasury should announce these sanctions before the end of 2018.
- **Take Chinese industrial policies to the WTO.** There is a case to be made against Chinese investment and industrial policies at the WTO in light of Chinese state intervention and its enormous global market share. Steps taken against China in the WTO should avoid giving China ammunition against the U.S.

### **China's Credibility**

The Chinese Communist Party wants Chinese firms to be taken as seriously as any other global competitor. The U.S. government should do more to make Chinese practices public knowledge as well as to bring into question the credibility of Chinese companies. The U.S. must both bring cases against China in the WTO and sanction known individual companies or violators. These actions will show the U.S. will no longer continue to allow the theft of American IP.

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