

ISSUE BRIEF

No. 4948 | APRIL 5, 2019

Enforcement: How the U.S. Should Hold China Accountable in the 301 Negotiations

Riley Walters

American and Chinese negotiators are attempting to reach an agreement that will eliminate, or phase out, China's commercial practices denounced by the Office of the U.S. Trade Representative (USTR) as a part of its Section 301 investigation—an assessment of how U.S. commercial interests are restricted in China.

The issue of enforcement continues to be a sticking point, potentially delaying any agreement. U.S. negotiators do not believe that China will uphold its end of the agreement unless there is a credible enforcement mechanism. The U.S. has an array of mechanisms with which to address the issues raised by the USTR—mechanisms that do not involve the punitive tariffs that the U.S. has placed on imports from China since July 6, 2018.

The U.S. should be concerned about upholding good investment practices, stopping the theft and proliferation of stolen intellectual property (IP), limiting how governments interfere in markets, and promoting free-market commercial practices instead of focusing on ways to enforce a Section 301 agreement. The Administration should pursue policies that benefit Americans by limiting the actions of bad actors by enforcing the rule of law and working with U.S. partners and allies to promote trade and investment.

This paper, in its entirety, can be found at <http://report.heritage.org/ib4948>

The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002
(202) 546-4400 | heritage.org

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

Current Enforcement Proposal

The USTR began its investigation into China's acts, policies, and practices related to technology transfer on August 18, 2017, under Section 301 of the Trade Act of 1974. During its investigation, the USTR found that "China's policies result in harm to the U.S. economy of at least \$50 billion per year."¹ The U.S. has since placed tariffs on over \$250 billion worth of imports from China. Despite U.S. efforts through unilateral action against Chinese imports, bilateral negotiations, and international admonishments, China has failed to take any substantive actions to address U.S. concerns, according to the USTR.²

This suggests that tariffs have failed to force China to change its practices. The current USTR proposal does suggest, however, continuing the use of tariffs as a means for enforcement. The proposal consists of three parts:³

- 1. Regular U.S.–China meetings.** Monthly meetings are to be held at the office director level, quarterly meetings at the vice-ministerial level, and semi-annual meetings at the ministerial level.
- 2. Anonymous complaint mechanism.** U.S. companies will be able to complain to the USTR if they have reason to believe that China is not living up to certain parts of the agreement. This will inform the USTR on certain trends in China's practices.
- 3. Punitive tariffs.** The USTR will attempt to solve complaints made by U.S. companies through the regular U.S.–China meetings led by the USTR. If these complaints are not solved either at the office

director, vice minister, or ministerial levels, the USTR will impose proportionate tariffs on Chinese imports.

This process is akin to the Section 301 process itself—whereby a domestic industry can file a complaint with the USTR, the USTR determines whether to initiate an investigation under Section 301, and potentially apply punitive tariffs on foreign imports—except without regulatory and congressional oversight. It would grant the USTR significant discretionary power to apply punitive tariffs if there are complaints over foreign ownership restrictions, licensing agreements, technology transfer and acquisition, cyber-enabled theft, and any other terms agreed to in a Section 301 agreement, such as the issue of state subsidies and exchange rates.

Enforcement

U.S.–Chinese economic relations do not end with a Section 301 agreement. Enforcing the rule of law, the issue at the center of the Section 301 investigation, should not be constrained and administered through an executive branch agreement. Congress should be critical of any such agreement that would give the USTR too much discretionary authority over U.S.–Chinese commercial relations.

Instead of using tariffs as a mechanism for enforcement, the Administration has a number of options that also limit the negative financial and economic impact on Americans. These include, but are not limited to:

- **Applying sanctions to those who have violated U.S. IP rights.** Executive Order 13694 grants the Treasury Department authority to sanction foreign entities that have used cyber-enabled means to acquire U.S. IP.⁴ In addition, the U.S. should pursue punitive action against those foreign entities that have violated U.S. IP rights abroad through non-cyber-enabled means.⁵ U.S. sanctions are successful in limiting the abilities of foreign entities doing business abroad.
- **Funding and making use of the Committee on Foreign Investment in the U.S. (CFIUS).** The CFIUS was recently updated to help deal with threats created by China’s foreign investment in the U.S.⁶ Two important updates are (1) protecting Americans’ personally identifiable information and (2) preventing the creation of new cybersecurity vulnerabilities. Now it is up to Congress to appropriately fund the committee’s members and their activities.
- **Supporting Department of Justice (DOJ) and Department of Defense (DOD) efforts to combat malicious Chinese activity.** The DOJ and DOD are actively working to deter and punish those bad actors that threaten the U.S. defense industrial base and commercial businesses.⁷ DOJ efforts to indict bad actors is important for building legal cases, such as in the case against Huawei Technologies, and potentially applying sanctions against Chinese companies that have violated American IP rights.

1. U.S. Trade Representative, “Section 301 Fact Sheet,” March 2018, <https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2018/march/section-301-fact-sheet> (accessed March 11, 2019).

2. U.S. Trade Representative, “Update Concerning China’s Acts, Policies and Practices Related to Technology Transfer, Intellectual Property, and Innovation,” November 20, 2018, <https://ustr.gov/sites/default/files/enforcement/301Investigations/301%20Report%20Update.pdf> (accessed March 11, 2019).

3. Ambassador Robert Lighthizer, “U.S.–China Trade,” testimony before the Ways and Means Committee, U.S. House of Representatives, February 27, 2019, <https://waysandmeans.house.gov/legislation/hearings/us-china-trade> (accessed March 20, 2019).

4. Executive Order 13694; see news release, “Text of a Notice to the Congress on the Continuation of the National Emergency with Respect to Significant Malicious Cyber-Enabled Activities,” The White House, March 26, 2019, <https://www.whitehouse.gov/briefings-statements/text-notice-congress-continuation-national-emergency-respect-significant-malicious-cyber-enabled-activities/> (accessed April 4, 2019).

5. Riley Walters, “U.S. Needs to Address Chinese Trade Distortions, But Section 301 Is Not the Way,” Heritage Foundation *Issue Brief* No. 4810, January 22, 2018, <https://www.heritage.org/trade/report/us-needs-address-chinese-trade-distortions-section-301-not-the-way>.

6. Thomas Callender, “The 2019 NDAA Provides Some Important New Authorities to Modernize the U.S. Military,” The Daily Signal, July 30, 2018, <https://www.dailysignal.com/2018/07/30/the-2019-ndaa-provides-some-important-new-authorities-to-modernize-the-u-s-military/>.

7. News release, “Attorney General Jeff Sessions Announces New Initiative to Combat Chinese Economic Espionage,” U.S. Department of Justice, November 1, 2018, <https://www.justice.gov/opa/speech/attorney-general-jeff-sessions-announces-new-initiative-combat-chinese-economic-espionage> (accessed March 20, 2019).

- **Encouraging more Section 337 investigations.** Section 337 of the Tariff Act of 1930—by allowing the U.S. International Trade Commission to respond quickly on behalf of victims—is an effective tool in limiting the import of goods that violate U.S. IP rights into the U.S. market.⁸
- **Increasing opportunities to coordinate with Chinese officials.** With the exception of the ongoing Section 301 negotiations, regular economic meetings with China have fallen by the wayside. The USTR’s efforts to restart regular meetings are a good start, but general meetings could limit negotiators’ ability to focus on China’s market liberalization. The U.S. should resume regular meetings on market liberalization in specific sectors.
- **Collecting information on state-owned enterprises (SOEs).** The USTR should demand that Beijing become transparent about the financial workings of its SOEs. The USTR and other agencies should collect information on SOEs in order to help build their case against China’s practices in both domestic and international legal action.⁹
- **Reforming and supporting the World Trade Organization (WTO).** History shows that the U.S. is very successful in winning cases at the WTO.¹⁰ The WTO dispute-settlement system requires adjustments, and the Trump Administration should work with free-market allies to implement them. But even in its current state, using the WTO is ideal in building collective action against China’s practices that harms U.S. and foreign companies abroad.

A More Effective Strategy

History shows that tariffs are easily levied, come with a cost, and are hard to remove. Given that the tariffs have yet to force China to change its practices, and have had a negative impact on the U.S. economy,¹¹ the Administration should:

- **Remove all tariffs related to Section 301 as soon as possible.** This will reduce any further economic burden on American businesses and consumers.
- **Pursue more effective policies toward China.** The list above presents a wide variety of measures already being taken that can be further supported, or policies not yet pursued, that could address China’s practices effectively. The U.S. should be more concerned about stopping China’s bad practices instead of finding ways to make China live up to a Section 301 agreement.

Congress has a constitutional obligation to regulate U.S. commercial activity and therefore should:
- **Review any new developments as part of Section 301 negotiations.** Congress should be wary of handing over too much regulatory power to the USTR. The USTR’s actions should be held within the limits established under the law.
- **Review existing trade laws.** It is important for Congress to understand that any Section 301 agreement is an executive agreement between the USTR and a foreign country. It is not a trade agreement negotiated under the auspices of Trade Promotion Authority.

8. Alden Abbot, “Section 337 of the Tariff Act: Fighting Distortionary Import Trade and Strengthening American Intellectual Property Rights,” Heritage Foundation *Background* No. 3114, June 2, 2016, <https://www.heritage.org/trade/report/section-337-the-tariff-act-fighting-distortionary-import-trade-and-strengthening>.

9. Derek Scissors, “How to Make China More Honest,” Heritage Foundation *Issue Brief* No. 2839, September 4, 2013, <https://www.heritage.org/asia/report/how-make-china-more-honest>.

10. Tori K. Whiting and Riley Walters, “The White House Needs Better Guidance on Its New China Trade Policy,” Heritage Foundation *Issue Brief* No. 4831, March 27, 2018, <https://www.heritage.org/trade/report/the-white-house-needs-better-guidance-its-new-china-trade-policy>.

11. Mary Amity, Stephen J. Redding, and David E. Weinstein, “The Impact of the 2018 Trade War on U.S. Prices and Welfare,” CEPR *Discussion Paper* No. 13564, March 2019, <https://cepr.org/content/free-dp-download-04-march-2019-impact-2018-trade-war-us-prices-and-welfare> (accessed March 11, 2019).

- **Consider implications of new tariff authorities.** An agreement that puts the burden on Beijing to settle U.S. concerns does not require changes to U.S. law or congressional action, but the application of Section 301 has been stretched beyond recognition. Congress should be wary of expanding the use of tariffs, even if under the guise of existing authorities, any further without additional legal authority.

Conclusion

U.S. relations with China are anything but simple. This complicated relationship requires complicated actions for dealing with issues like IP theft. The U.S. has a variety of actions it can pursue in dealing with China's bad practices besides resorting to tariffs.

—*Riley Walters is Policy Analyst in the Asian Studies Center, of the Kathryn and Shelby Cullom Davis Institute for National Security and Foreign Policy, at The Heritage Foundation.*