

China Briefing E: Openness to U.S. Trade and Investment Generates Limited Economic Benefits for China

In this simulation, you will be part of a team of negotiators representing China in trade talks with the United States. **Your goal is to represent the interests of Chinese businesses and consumers who might be harmed by trade and investment with the United States** and to ensure that any agreement reached between the two countries will reflect these interests.

If no agreement is reached by the end of negotiations, tariffs on \$200 billion worth of Chinese goods will increase from 10% to 25%. To put this figure in perspective, China exported approximately \$522.9 billion worth of goods and services to the U.S. and imported \$187.5 billion worth in 2017.

Why U.S. Trade and Investment Generate Limited Economic Benefits for China

The majority of China's export-led growth comes from processing trade (a.k.a. contract manufacturing, where exporters import inputs, assemble, and re-export the final products). Multinational firms operating in China capture the vast majority of the value added in this process. For example, China still earns only 2% the total value for each iPhone it assembles and exports to the rest of the world.

Multinational firms have taken advantage of China's low input costs while transferring limited technology to China's domestic firms. Research has shown no evidence of a steady narrowing in export quality between foreign enterprises and China's domestic suppliers. Most multinationals engage in little truly cutting edge R&D in China. Most of China's recent growth in export has come from intensive margin (exports keep on getting cheaper), which is not sustainable with China's rising labor costs.

In addition, reliance on processing trade means that China's prosperity is vulnerably tied to the fluctuating demands in western markets. China's decision to open its doors, to use its abundant and cheap labor force to participate in the global division of labor, and to welcome foreign capital, and in the form of processing trade, make full use of inter-firm trade within multinational corporations to promote exports, may have helped promote domestic economic growth through exports *in the past*, but it is increasingly unsustainable as China runs out of surplus labor. China has also paid a hefty environmental price serving as the world's factory at the low-end of the global production chain.

Concerns about U.S.-China Trade and Investment Relations

Because you represent interests that consider U.S.-China trade to be of limited benefit to China, your main concerns are to **defend China's techno-industrial policies** in order to elevate China away from its relative low status on the global production chain and to capture more of the value added. You also want to accelerate technology transfer from the U.S. to China and to make sure that U.S.-China trade and investment serve China's national development goals:

Only a small number of developing countries such as Japan and South Korea managed to join the ranks of high-income countries in the past century. They have done so by establishing competitive home-grown industries in capital- and technology-intensive manufacturing sectors. The state played a substantial strategic role in the economic success of these developmental states. However, the rules that govern global trade has become much less permissive of industrial policies since the WTO came into force in 1995. Practices, like technology licensing agreements, were discouraged in favor of unrestricted foreign direct investment flows, which allowed foreign investors greater control over technology transfers. Rules that

focused on reducing tariff barriers were expanded to the service sector, intellectual property rights and domestic subsidies, among other areas. These rules favor businesses from already developed countries and effectively reduced the policy space of developing countries to become rich themselves.

When China started its economic reform and opening, it faced tough policy choices in order to join the WTO. Chinese and American policymakers were well aware of what China had (and had not) signed up to. China's policymakers today should remember that, by itself, opening up is not an objective. At any given stage of development, designing an opening-up strategy is to realize national objectives for that stage of development. China is not obligated to make any additional concessions in areas like government procurement and antitrust enforcement that lay outside of its WTO obligations. The United States must also recognize that China has already paid a high price by opening its markets to trade and investment. The reforms to state-owned enterprises in the 1990s that enabled China's accession to the World Trade Organization (WTO) led to approximately 35% of their workforce, or forty million workers, being laid off over five years.

With China's aging workforce and rising wages, the reliance on labor intensive, export-oriented growth is increasingly unsustainable and China must reorient its growth model from high growth to high quality, balanced, and sustainable growth. Industrial policies that support emerging strategic industries play an important role in this process and cannot be compromised.

In addition, the United States' concern about trade deficit with China is completely misplaced. A majority of this deficit can be attributed to the export of assembled final products by multinational corporations operating in China. China's current relative low status on the global production chain has determined its trade position with the United States. This deficit will not decrease unless China can rely on its industrial policy to alter the distribution of comparative advantages across the two countries.

Formulating a Negotiation Strategy: Opening-up the Economy must Serve State Goals for National Development

China should remind the United States that reducing tariffs to 2017 levels serves the interest of both economies. Some concessions can be made but we should be careful that these do not undermine China's long-term economic development:

Policy Recommendations

Minor Concessions (-10-20 points)

1. **Increasing imports of American goods** without undermining China's food and energy security (such a purchase agreement would help Chinese consumers by lowering prices, help U.S. producers of soybeans, natural gas, oil, and help reduce the trade deficit between the U.S. and China)
2. **Strengthen intellectual property protection**, trade secret protection, and counterpiracy enforcement (these policies strengthen the rule of law in China and protect all innovative and productive companies, whether they are American or Chinese)
1. **Reform specific policies and practices linked to forced technology transfer** (the new Foreign Investment Law passed in March 2019 already contains language that make it illegal to force foreign companies to surrender technology to Chinese partners)

Major Concessions (-20-40 points Individual Points)

2. **China should NOT support any deal that would eliminate the state's ability to support emerging industries** and promote innovation through industrial policy (MiC 2025 may need to be walked back, but the government must not surrender the right to use subsidies and regulations to promote domestic industries and develop cutting edge technology)
3. **China should issue a limited negative list for foreign investment that reduces barriers of entry** for foreign investment by placing restrictions on foreign ownership in fewer sectors (the negative list sets apart some sectors that are not open for foreign investment. China fight for a longer negative list because opening up more sectors to investment by U.S. companies will increase economic pressure on domestic companies and risk giving foreigners control over the Chinese economy)

In exchange, China should demand the following concessions from the United States:

High Priority Asks (20-40 points)

1. **Reduce tariffs on Chinese imports to 2017 levels** (there are currently 25% tariffs on \$50 billion and 10% tariffs on another \$200 billion of Chinese imports and retaliatory tariffs of 10-25% tariffs on \$110 billion of U.S. imports, these tariffs hurt consumers and businesses in both countries and should be walked back as part of any deal)
2. **U.S. should refrain from sanctioning Chinese firms such as Huawei and ZTE** (the U.S. has accused Huawei and ZTE of violating American sanctions against Iran and North Korea and threatened to deny them access American made components and blocked them from American markets, China should seek reciprocity in fair treatment of Chinese firms in the U.S. if it grants greater market access to U.S. firms in China)
3. **The U.S. can agree to take a more limited approach in defining its export control regime** regarding the export of dual-use technologies (the U.S. export control regime is under review at present and it is in China's interest to make sure the new rules will not be used to ban most or all high technology exports to China)

Low Priority Asks (10-20 points)

4. **Open government procurement to Chinese technology products and services** (the U.S. government is the largest customer in many sectors, another important part of reciprocal market access is to open up government procurement to foreign competition)
5. **Refrain from restricting visas for Chinese students and professionals** (many Chinese study and work in the U.S., even though some have been linked to espionage and political meddling, the vast majority are law abiding and want to become U.S. citizens. Reversing this brain drain of talent leaving China for the U.S. could be a silver lining of the trade war)

You have no position on the following issues (will not lose or gain individual points):

Asks

1. **The U.S. to agree not to send warships or military personnel to Taiwan** or to conduct military exercises with Taiwan in return for Beijing not to undertake provocative military actions in the Taiwan Strait
2. **The U.S. can agree to take a more limited approach in defining its export control regime** regarding the export of dual-use technologies (the U.S. export control regime is under review at present and the U.S. can take steps to reassure China that it will not be abused to ban most or all high technology exports to China but limited to those that have important military applications)

- 3. The U.S. to recognize core Chinese national interests:** keeping national unity of mainland China and Tibet, Xinjiang, and Hong Kong is very important to Beijing but problematic for Washington from the perspective of human rights

Concessions

- 1. China to refrain from military development of man-made islands in the South China Sea,** commit to not occupy other contested shoals, and agree to establish confidence building measures to lessen the risk of accidental military conflict
- 2. China to help identify and discourage Chinese firms that evade U.S. sanctions against Iran and North Korea** (companies such as Huawei and ZTE stand accused of violating American sanctions against Iran and North Korea, the U.S. should refrain from putting sanctions on these companies as a gesture of good will to China during trade talks)

Win Conditions:

Agreement is considered reached when ALL members from BOTH country teams sign the **Joint-Statement** paper

Individual Victory: The individual who has the **best negotiation performance, most optimal individual demands and concessions** with regards to the **best individual points ratio** on the **Position Paper** will be declared winner as the individual negotiator. This can occur regardless of which team wins, and regardless of whether agreement is reached or not. (Moderator will take in consideration of each individual role)

Team Victory: The country team with the most National Points will be declared winner of the Simulation. This can only occur if agreement is reached.

Impasse: If no agreement is reached by the end of negotiation, both country teams will receive -20 National Points. Moderator will then determine which country team is ahead based on National Points negotiated at that time. Individual victory is still possible under impasse and preferable to making costly concessions to achieve team victory.