

Trump left China's worst trade practices for daunting 'phase two' talks

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President Trump will be facing a difficult task when he travels to China later this year to start "phase two" of trade negotiations with Beijing.

The talks are expected to cover digital trade, China's business subsidies, and its hacking of U.S. companies, according to White House officials — all of which issues are so tricky that they got excluded from the first round of talks.

Furthermore, Trump now has less room to maneuver because of the promises he made to China in the first round of talks, some of which limit his leverage over Chinese negotiators.

“China was brought to table on 'phase one' by tariffs, and we've just promised not to impose more. So, we'd need another set of actions to make 'phase two' work,” noted Derek Scissors, a resident scholar at the American Enterprise Institute, a conservative think tank.

The administration would have to punish specific Chinese companies that benefit from hacking or subsidies, among other possibilities, Scissors said. “But we haven't taken even the first step in that direction.”

Trump has repeatedly said that a full trade deal may not come before the 2020 election. He has claimed that China is dragging its heels in the hopes that he loses his reelection bid and a Democratic White House takes over. He has also said he doesn't mind waiting until after the election, but getting a deal before it would be a big boost to his reelection prospects.

The task is also especially daunting because the negotiating items are ones that fell out of "phase one" because they proved intractable. "Digital trade, you know, as you know, those are difficult issues," a White House official acknowledged to reporters after "phase one." "With China, we're actually planning to address those in future negotiations."

Subsidies to Chinese companies and support for state-owned enterprises allow the companies to operate at a loss and thereby undercut foreign competitors. Addressing the subsidies is difficult because they come in many forms, said William Reinsch of the Center for Strategic and International Studies. Does, for example, a state utility giving a company discounted electricity constitute a subsidy?

Another issue is that Chinese companies tend to act in Beijing's interest over their own financial bottom lines even when they don't explicitly have to. “A colleague of mine said here are only two types of business in China: the ones that are owned by the government and ones that shut up and do what the government tells them to do,” Reinsch said.

The United States needs to push China to these privatize companies or let them go bankrupt. China is unlikely to comply, but the U.S. could prod Beijing to cut loose from specific companies. “That would be a way to produce measurable benefits,” Reinsch said.

The two main digital trade issues are Chinese laws requiring “important data” to be stored and processed locally and prohibitions on the data being transferred out of the country. The data can range from personal information to financial records to trade secrets. The practice allows China to restrict market access if the localization requirements are not met. The transfer limitations, meanwhile, prevent U.S. companies from making full use of the info.

U.S. companies want the White House to pressure Beijing to lessen and clarify restrictions that mandate data localization for network owners and operators that maintain critical information infrastructure in China, said a trade association representative who requested anonymity.

Getting it to give up that advantage is another matter entirely, noted Simon Lester, trade policy analyst for the free market Cato Institute. “I will be shocked if China agrees to any provisions that would affect its policies related to data localization and cross-border data transfers,” he said.

Beijing has denied that it hacks into U.S. companies, but the Justice Department has indicted multiple alleged Chinese hackers in 2019 alone. Reuters reported last month that the National Association of Manufacturers, a trade policy association, was hacked over the summer, and an investigation determined the attack came from China.

Whether hacking is an issue for a trade deal isn't clear, said the ITIC official. Hacking that is not for economic gain is considered traditional espionage and therefore a criminal matter, not a trade issue.

Another problem for the administration is that many issues involving "phase one" still aren't resolved. The actual text of that deal has not been made public. That frustrates many trade groups.

“From a substantive standpoint, want to see what the deal looks like. If ‘phase one’ doesn’t address those issues, then we want to make sure that ‘phase two’ does,” said Ed Brzytwa, director of international trade for the American Chemistry Council, a trade association.