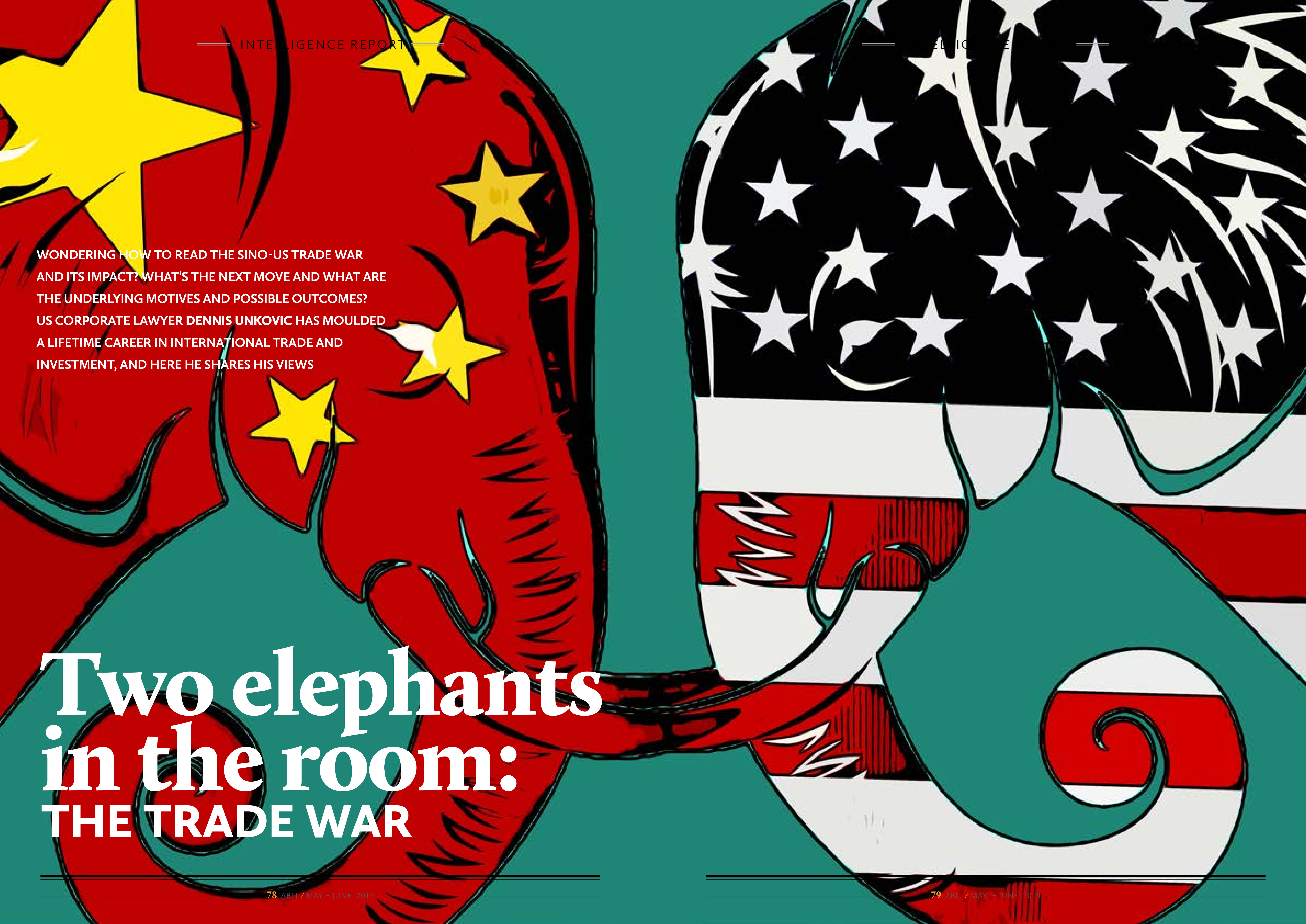

WONDERING HOW TO READ THE SINO-US TRADE WAR AND ITS IMPACT? WHAT'S THE NEXT MOVE AND WHAT ARE THE UNDERLYING MOTIVES AND POSSIBLE OUTCOMES? US CORPORATE LAWYER **DENNIS UNKOVIC** HAS MOULDED A LIFETIME CAREER IN INTERNATIONAL TRADE AND INVESTMENT, AND HERE HE SHARES HIS VIEWS

Two elephants in the room:
THE TRADE WAR

The US and China, like two alpha elephants trumpeting at each other, are currently engaged in their most protracted economic and political conflict in 40 years. This latest confrontation has escalated to the point where the Trump administration has levied high tariffs on most Chinese manufactured products destined for American consumers. In retaliation, China has imposed its own set of tariffs on US exports to China. So, why do things seem to be going from bad to worse? And what can we expect next?

The first sign of trouble came more than two years ago, when US President Donald Trump, shortly after his inauguration, abruptly, and to many unexpectedly, withdrew the US from the Trans-Pacific Partnership (TPP). The following year, as the US trade deficit worsened, the Trump administration announced the imposition of a first round of tariffs on selected Chinese-manufactured goods coming into the US.

The Chinese retaliated. Since then, three rounds of negotiations between Chinese and US trade officials failed to resolve the rift, which has blossomed into a full-blown crisis.

America's massive US$351 billion trade deficit with China in 2018 is the primary justification behind the Trump administration's targeting of China and its trade policies, including charges of the theft of American intellectual property and technologies by the Chinese. China exported about US$521 billion worth of manufactured goods to the US in 2017, while the US only exported about US$170 billion worth of goods and agricultural products (such as soybeans) to China. It is worth noting that this US$351 billion deficit only applies to the sale of goods and products; the US in 2018 had a favourable balance in selling services to China.

Obviously, the trade deficit did not occur overnight – it first began to accumulate in the 1980s, when many American manufacturing companies decided to abandon the US in order to set up their manufacturing operations in China, hoping to take advantage of China's lower-priced labour market. Many of those Chinese-made goods were exported back to the US. Over time, manufacturing in the US went into decline and the trade deficit with China grew larger.

Frankly, there is no short-run solution that can erase the China-US trade deficit because the three largest sectors of US exports to China are aircraft (US$17 billion), soybeans and agricultural produce (US$12.25 billion), and motor vehicles (US$10.3 billion). Each of these sectors can be replaced by competitors of US companies coming from other countries around the world. For example, Airbus would gladly supplant Boeing as the major supplier of aircraft to China's enormous aerospace market.

Even if China decided to pursue an aggressive policy to purchase much larger quantities of goods from the US, it is unlikely that there are enough American-made products today that would attract Chinese buyers; thus, the dispute continues.

TARIFFS AND OTHER TOOLS

The Trump administration's immediate reaction to this out of control trade deficit was to impose tariffs on Chinese exports of products to the US. Tariffs are a blunt instrument. Unfortunately, many individuals, including some prominent officials within the US government, misunderstand how tariffs work, and who actually ends up paying the real costs of tariffs.

Tariffs are not "penalties" paid by nations or companies that import goods into another country. It is the actual importers of products who are required to pay tariffs (or duties) to the government in order to import goods. Importers ultimately pass on the cost of the tariffs. In short, it is consumers, not foreign governments, who pay the price for the tariffs.

Because raising tariffs alone on Chinese goods destined for the US hasn't worked so far to pressure China into changing its policies, the US government is now turning toward using non-tariff approaches – one example is the Committee on Foreign Investment in the United States (CFIUS). The CFIUS is the administrative body within the US government that has the power to review proposals by foreign governments or foreign companies when they try to invest in or purchase American companies and real estate.

If a transaction is judged by the CFIUS to adversely affect the "national security interests of the US", then the president has broad discretionary powers to block or to reverse an already completed transaction involving a non-US company or foreign government. While the CFIUS does focus on all potential foreign investments that might affect US "national security interests", those administering the CFIUS review process appear to be giving a higher priority to closely examining Chinese investments more than investments from elsewhere.

The largest and highest-profile CFIUS decision to date occurred when the CFIUS advised President Trump to intervene to block Broadcom's multibillion-dollar bid to buy the US-based tech giant, Qualcomm.

More recently, the Trump administration stepped up pressure on China when it imposed a "ban" on goods produced by China's telecom giant, Huawei. China reacted strongly against this initiative targeting one of its premier technology companies. China has threatened to impose its own set of retaliatory actions. In addition, China is expected to apply a broad range of "non-tariff barriers" on US-sourced products as a way to counteract American influence over China. Unless a global settlement between China and the US is announced soon, it is likely that the relationship will worsen.

WHAT DOES THIS MEAN?

In the past 40 years, the role played by multilateral trade treaties has been at the heart of international business. These international treaties have been the mechanisms by which there has been a vast increase in global trade among nations. While many nations have benefited, the impact has been less positive for countries like the US, which is basically a consumer-based economy.

As a result, the US has tended to import more consumer products, and thus the US has run up higher trade deficits with other countries. Expressing its frustration with what it viewed as ineffective enforcement mechanisms contained in multilateral trade treaties including the World Trade Organization (WTO), the US and increasing numbers of other countries are considering creating bilateral relationships as an alternative approach.

For example, last year the US forced a renegotiation of the North American Free Trade Agreement (NAFTA) with its neighbours Canada and Mexico, which had been in place since 1994. The US negotiators focused separately on the Mexicans and then the Canadians as a way to extract concessions. The new treaty, known as the United States-Mexico-Canada Agreement (USMCA), is now up for approval before the US Congress. On 19 June, by a vote of 114 in favour and four against in the Mexican senate, Mexico became the first of the three countries to officially ratify the USMCA.

During an official state visit to Japan in late May, 2019, to meet with Japanese Prime Minister Shinzo Abe, the US pushed its agenda to move toward more bilateral trade relations between Japan and the US. This was an obvious move to lessen the impact of multilateral trade treaties.

It is important to understand it is not just the US that is pursuing more bilateral treaties; the Indonesian government has publicly expressed its dissatisfaction with how mandatory investor arbitration has, in its view, hurt the Indonesian government, as disputes with international investors in Indonesia have grown. Indonesia sees bilateral agreements as its future. Even prior to the Trump administration, bilateral trade treaties were of interest to policymakers in the US. The US-Korea Free Trade Agreement, first signed in June 2007 by then president George W. Bush, was renegotiated in March 2018.

China, likewise, is moving beyond the existing multilateral treaty mechanisms and toward negotiating more bilateral relationships. In aggressively pushing its ambitious Belt & Road Initiative, China is approaching individual countries throughout Asia and Europe, seeking out partners for its long-term economic development programme of a trade route stretching from China into Europe.

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For foreign companies, their strategic planners and legal advisers seeking to do business with the US, there are four trends to watch carefully.

1. Expect in the future that the US government will continue to pursue more bilateral trade relationships with all its trading partners. This trend will significantly affect those companies that are heavily reliant on multilateral organizations like the WTO to conduct and monitor international business activities.
2. "National security" concerns of US policy- makers and the US Congress will continue to be a high priority. As a result, mechanisms like the CFIUS will become increasingly important for US trade officials. This will impact all non-US companies seeking to do business in the US, or which plan to invest in US companies and real estate. It is important to recognize that both the EU and China are now creating their own "CFIUS-like" laws and regulations to monitor foreign investment.
3. The "America First" rhetoric espoused by the Trump administration should play a major role in the oncoming US presidential election, so it is unlikely to diminish over the next 18 months. If re-elected in 2020, the Trump administration is likely to pursue this policy with even greater emphasis in a second term.
4. Expect US-Chinese relations to go both up and down in the future. While China and the US will not be directly confrontational at all points, the growing competition between these two large elephants in the room is unlikely to abate.

No matter how the China-US trade war develops in the next year, it is obvious the tensions are more than just about tariffs. The US views China as its single most important competitor in the future – economically, diplomatically and militarily. I predict the future ahead for US-China relations will be uneven and at some times confrontational.

Dennis Unkovic is a partner at US law firm Meyer Unkovic & Scott. He has extensive experience in negotiating transactions, foreign and domestic, on international investments, and advising on inbound and outbound direct foreign investment projects. He works for both US companies and foreign entities with their international activities and investments, and has travelled to 64 countries in the past 35 years, with significant involvement in transactions in China, India, Japan, Korea and around Southeast Asia.