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Enforcing U.S. Trade Laws: Section 301 and China

Overview

Concerns over China's policies on intellectual property (IP), technology, and innovation led the Trump Administration in August 2017 to launch a Section 301 investigation of those policies. Consequently, the United States has implemented three rounds of tariff increases on a total of \$250 billion worth of Chinese products, while China has increased tariffs on \$110 billion worth of U.S. products. The Trump Administration has threatened to increase tariffs on nearly all imports from China.

What Is Section 301 and How Does It Work?

Sections 301 through 310 of the Trade Act of 1974, as amended, are commonly referred to as "Section 301." It is one of the principal statutory means by which the United States enforces U.S. rights under trade agreements and addresses "unfair" foreign barriers to U.S. exports.

Since 1974, the USTR has initiated 125 Section 301 cases, retaliating in 17 instances.

Section 301 procedures apply to foreign acts, policies, and practices that the USTR determines either (1) violate, or are inconsistent with, a trade agreement; or (2) are unjustifiable and burden or restrict U.S. commerce. The measure sets procedures and timetables for actions based on the type of trade barrier(s) addressed. Section 301 cases can be initiated as a result of a petition filed by an interested party with the USTR or initiated by the USTR. Once the USTR begins a Section 301 investigation, it must seek a negotiated settlement with the foreign country concerned, either through compensation or an elimination of the particular barrier or practice. For cases involving trade agreements, such as those under the Uruguay Round (UR) agreements in the World Trade Organization (WTO), the USTR is required to use the formal dispute proceedings specified by the agreement. For Section 301 cases (except those involving a trade agreement or an IPR issue) the USTR has 12 to 18 months to seek a negotiated resolution. If one is not obtained, the USTR determines whether or not to retaliate (which usually takes the form of increased tariffs on selected imports) at a level equivalent to the estimated economic losses incurred by U.S. firms from the foreign barrier or practice.

After the United States implemented the UR agreements and joined the WTO in 1995, the USTR still sometimes began Section 301 investigations but then brought the issues at hand to the WTO for dispute resolution. After 2010, the USTR brought all trade disputes involving WTO members directly to the WTO for adjudication. The Trump Administration's use of Section 301, rather than solely utilizing the WTO dispute settlement process to address the issues of concern, is a departure from past U.S. practices.

Past Section 301 Use and China

Prior to the UR agreements, China was a major target of Section 301 actions. In 1992 and 1994, the United States

threatened to impose increased tariffs against China over its IPR policies. In 1992, the United States threatened increased tariffs on \$3.9 billion worth of Chinese goods over market access issues. These cases resulted in bilateral agreements before tariff hikes were implemented. In October 2010, the USTR launched a Section 301 investigation into Chinese policies affecting trade and investment in green technologies, and in December 2010, the USTR brought a WTO dispute settlement case against China, but only in regard to its wind power subsidies. In March 2012, the USTR initiated a WTO dispute case against China's export restrictions on rare earth elements (used in a number of green technology products). The United States largely prevailed in both cases.

New U.S. Section 301 Measures Against China

On March 22, 2018, President Trump signed a *Memorandum on Actions by the United States Related to the Section 301 Investigation*. Described by the White House as a targeting of China's "economic aggression," the memorandum identified four broad policies that justified U.S. action against China under Section 301. It said China

- uses joint venture requirements, foreign investment restrictions, and administrative review and licensing processes to force or pressure technology transfers from U.S. companies to a Chinese entity;
- maintains unfair licensing practices that prevent U.S. firms from getting market-based returns for their IP;
- directs and facilitates investments and acquisitions which generate large-scale technology and IP transfer to support China's industrial policy goals, such as the *Made in China 2025* (MIC 2025) initiative; and
- conducts and supports cyberintrusions into U.S. computer networks to gain access to valuable business information.

In response to these policies, the Administration proposed to (1) direct the USTR to consider implementing tariff increases on imports from China; (2) initiate a WTO dispute settlement case against China's "discriminatory" technology licensing (which it did on March 23); and (3) propose new investment restrictions on Chinese efforts to acquire sensitive U.S. technology. In announcing these measures, President Trump also stated that he had asked China to "reduce the trade deficit immediately by \$100 billion" (later raised to \$200 billion over two years), and emphasized that trade should be "reciprocal." On April 3, the USTR released a list of proposed 25% tariff hikes on \$50 billion worth of imports from China (a level the USTR estimated was comparable to annual U.S. economic losses stemming from China's IP and technology policies). China threatened to retaliate and initiated a WTO dispute settlement case against the United States on April 4.

U.S.-China Negotiations

On May 3-4, 2018, the two sides held high-level talks in Beijing. The U.S. side released a draft Framework for Discussion. It included calls for China to reduce the bilateral trade imbalance by \$200 billion over two years; address each of the four practices identified in the Section 301 findings; halt subsidies for the *Made in China 2025* initiative; remove foreign investment restrictions, make China's tariff levels comparable to U.S. tariff rates, and remove certain nontariff barriers; improve market access for U.S. service providers and agricultural products; and agree not to oppose, challenge, or take any other action against the United States' action, including in the WTO, if China failed to live up to a framework agreement. On May 19, the United States and China released a joint statement outlining progress on a number of trade issues. China agreed that it would "significantly increase purchases of United States goods and services," including U.S. agricultural and energy products, and would strengthen its IPR laws and regulations. On May 21, 2018, U.S. Secretary of the Treasury Steven Mnuchin stated that because of the agreement, the trade war had been put "on hold." However, on May 29, the White House announced that it planned to move ahead with Section 301 action against China by (1) imposing 25% ad valorem tariffs on \$50 billion worth of imports from China; (2) implementing new investment restrictions and enhanced export controls on Chinese entities and persons in regard to the acquisition of "industrially significant technology" for national security purposes (legislation was later enacted addressing these issues); and (3) continuing to pursue the WTO case against China's licensing policies. The White House further stated that it would request China to remove "all of its many trade barriers" and make taxes and tariffs between the two countries "reciprocal in nature and value." A subsequent statement by the Chinese government said that the White House actions were "clearly contrary to the recent agreement between the two sides," and said it would not implement the market-opening measures it had pledged to make while being threatened with tariff hikes.

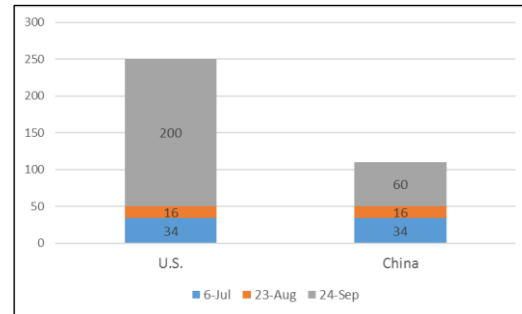
Punitive Tariffs Are Implemented

On June 15, 2018, the USTR announced a two-stage plan to impose 25% ad valorem tariffs on \$50 billion worth of Chinese imports. When China on June 16 issued its own two-stage retaliation plan against the United States, President Trump directed the USTR on June 18 to propose a new list of products worth \$200 billion that would be subject to increased 10% tariffs if China retaliated against U.S. tariff hikes, and he warned of additional tariffs if China retaliated a second time. The first two rounds of U.S. 25% tariff hike measures went into effect on July 6 (covering \$34 billion worth of products) and on August 23 (on \$16 billion worth of products). China implemented comparable countermeasures on U.S. products.

On September 17, 2018, the Trump Administration announced a third round of tariffs (at 10%, increasing to 25% on January 1, 2019) on \$200 billion worth of Chinese products, effective September 24. On the same day, China raised tariffs (by 5% and 10%) on \$60 billion worth of imports from the United States.

Figure 1. Three Rounds of Tariff Hikes in 2018

Total Products Affected (\$ in billions) and Effective Dates



Source: USTR and Chinese Ministry of Commerce.

Note: Tariff rates vary. Both sides raised tariffs on Round 3 products in May 2019.

A Trade Truce Falters and Trade Conflict Resumes

On December 1, 2018, Presidents Trump and Xi met at a private dinner during the G20 Summit in Argentina. According to a White House statement, China agreed to make "very substantial" purchases of U.S. products and to begin negotiations on making structural changes to various aspects of its economy with the goal of achieving an agreement in 90 days. President Trump agreed to suspend the planned Round 3 Section 301 tariff rate increases (which were set to take effect on January 1, 2019), but stated that the increases would be implemented if no agreement was reached in 90 days. After several rounds of bilateral negotiations, President Trump on February 24, 2019, tweeted that he would delay the tariff hikes because of progress in trade talks. However, on May 5, President Trump tweeted that trade negotiations were going "too slowly" and said he would raise tariffs from 10% to 25% on the third round of Section 301 tariff hikes on May 10 (which occurred). He further threatened to impose 25% tariff hikes on all remaining U.S. imports from China. On May 8, he accused China of attempting to backtrack on previous commitments. On May 13, 2019, China announced it would increase tariffs on its Third Round retaliation list on U.S. products (effective June 1, 2019). On the same day, the USTR issued a draft notice calling for public comment on proposed 25% tariff hikes covering approximately \$300 billion in Chinese goods, or essentially all products not currently covered by Section 301 action, except pharmaceuticals, certain pharmaceutical inputs, select medical goods, rare earth materials, and critical minerals.

A protracted and expanding U.S.-China trade conflict could sharply reduce bilateral commercial ties, disrupt international supply chains, and diminish global economic growth. The U.S. tariff hike from 10% to 25% on \$200 billion worth of Chinese products along with the Administration's threat to increase tariffs on nearly all remaining imports from China could lead to sharp price increases in the United States for a variety of products, negatively impacting U.S. consumers and firms that utilize Chinese parts and components. China could further retaliate by limiting operations of U.S.-invested firms in China or reducing its holdings of U.S. Treasury securities.

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