

WHAT I LEARNED THIS WEEK

Excerpt from March 15, 2018

5 The devastating potential of a rapidly-escalating technological trade war.

In a thinly-veiled threat to the Chinese last week, President Trump tweeted: **“The U.S. is acting swiftly on Intellectual Property theft. We cannot allow this to happen as it has for many years!”** Findings of the Administration’s Section 301 investigation into China’s IP theft and policy of “forced technology transfer” are due by August. The tweet implies action will likely come far sooner.

A provision of the 1974 Trade Act, Section 301 gives the president broad authority to punish foreign governments for practices harmful to American business. According to *The New York Times*: **“All together, intellectual-property theft costs America up to \$600 billion a year, the greatest transfer of wealth in history. China accounts for most of that loss.”** The Section 301 investigation could result in retaliatory measures ranging from sanctions and tariffs to a further crackdown on Chinese M&A activity, the banning of Chinese tech companies from doing business in the U.S., and even restrictions on Chinese immigration.

Yet, while the Section 301 investigation may be the primary threat, it is hardly the sole pressure point. From Trump blocking Broadcom’s \$117 billion bid for Qualcomm this week to the solar tariffs levied in late January to the Administration and lawmaker pressure that forced AT&T to cancel a deal with Chinese cell-phone giant Huawei at the start of the year, **“national security” is increasingly being used as a catch-all justification for arresting China’s infiltration into the U.S. tech industries of today and tomorrow.**

Given Trump’s impulsivity, it’s impossible to know where a trade war could go. It could lead to a Balkanized “splinternet”—the fracturing of the World Wide Web into regional digital ecosystems. It could cause the downfall of the rules-based regime that has governed global trade for decades. **It could be a slippery-slope into Thucydides Trap (WILTW August 24, 2017)—a trade**

war escalating into real armed conflict between the U.S. and China. Or it could peter out as Trump's attention is drawn elsewhere, or congressional, media, and electorate pressure restrains him. While time will tell, one truth is clear: **the more technological protectionism escalates, the more dangerous underestimating the possibilities becomes.**

Erudite as always, our favorite columnist, Rana Foroohar, wrote for *The Financial Times* this week:

*National security is the new cover for US protectionism. President Donald Trump signed his steel and aluminium tariffs under that false guise. But **metal bending is not the most worrisome new area for protectionism.** Trade in physical goods and services has been flat for years, but digital flows of commerce and information have risen by 45-fold in the past decade, according to the McKinsey Global Institute. **The trade war to fear is not in physical commodities, but in technology, which economic nationalists hope to ringfence in order to stave off competitive threats from countries such as China.***

The tensions that got the U.S. and China to this point are clear. Chinese technology policy has long been viewed by many American political and business leaders as creating an uneven playing field. China's blocking of U.S. information platforms—whether Google, Facebook, or Twitter—has been one primary complaint. "Technology transfer" is another—the Chinese requirement that, in order to do business in the country, foreign tech firms must partner with domestic companies and share or license their IP with those partners. **From Bush 43 to Obama, U.S. presidents avoided decisive countermeasures fearing confrontation might slow China's capitalist transformation and integration into the global free trade system.** As Bush once said: "Trade freely with China, and time is on our side."

Meanwhile, whether trade deals or WTO policy, the global trading system has failed to adapt to the dynamics of Digital Age cross-border exchange. Under Obama, the U.S. was leading efforts to set new global standards, negotiating an IP-focused digital trading regime into TPP—**viewed by TPP defenders as the main reason why it was in the U.S.'s interest to sign the deal.** The U.S.'s withdrawal has resulted in many of those provisions being stripped out.

This lack of necessary adaptation has crippled the credibility of, and in turn, nation-by-nation commitment to the existing rules-based regime. As *The Economist* wrote earlier this month:

*Desperately in need of new rules but unable to create them, the WTO has been disappointing many of its members, perhaps none more so than America. **Digital trade remains outside the WTO system.** Services are inconsistently covered. Without new rules, its judges have found themselves interpreting the ambiguities in old ones in a way that looks to some like overreach... **Lawyers like Robert Lighthizer, the United States Trade Representative, grumble that the WTO has allowed China to take advantage of everyone else and its outdated rules have stopped America protecting itself.***

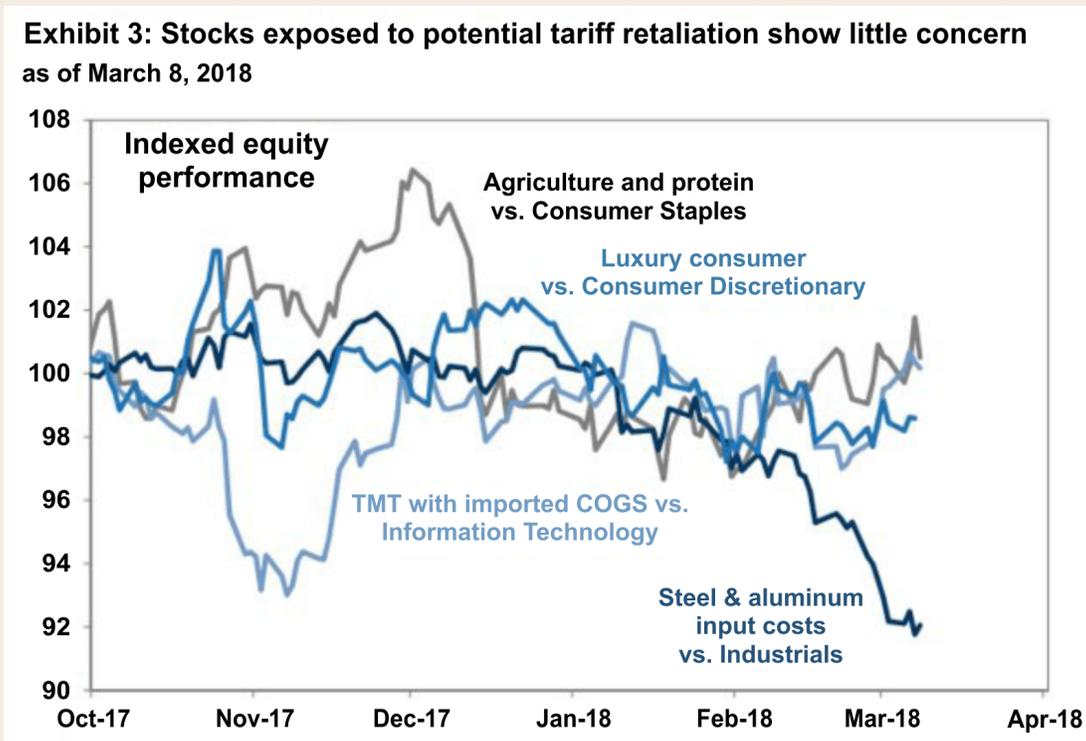
Lighthizer is leading the Trump Administration's Section 301 investigation. Peter Navarro, the White House trade chief, wrote a book on trade called *Death by China*. And of course, **Donald Trump infamously claimed on the campaign trail that "China has raped the U.S."** Globalists like Jared Kushner, Gary Cohn, and Rex Tillerson were thought by many as counterbalancing voices restraining the Administration's trade war impulses. Now with Kushner disempowered by a revoked security clearance, Cohn quitting, and Tillerson fired earlier this week, those barriers appear to be falling. Even with Larry Kudlow—who has publicly spoken out against the steel and aluminum tariffs—reportedly replacing Cohn, the Administration tide towards aggressive protectionism appears irreversible.

Trump's trade retaliation against China could come sooner and prove far more severe than markets anticipate. Protecting the industries of the future is clearly the focal point of the protectionist agenda, from the Administration to its allies in Congress. Alibaba's purchase of MoneyGram was blocked to protect against China owning a stake in the U.S.'s cashless future. The AT&T deal with Huawei was lobbied against out of fear the U.S. would become dependent on Chinese equipment as it deploys 5G networks. And the Broadcom deal was blocked out of fear the firm would starve Qualcomm of R&D investment. As Foroohar writes: "[The Committee on Foreign Investment's] theory is that if Qualcomm is starved of investment, the US will lose a 'national champion' in the technology race against China."

How China retaliates to Trump protectionism is impossible to predict.

Logically, they would target U.S. firms with sizable technology businesses in China, with Apple thought by many a likely victim. However, China may take a different approach, as evidenced by the fact they launched an investigation into imports of U.S. sorghum in retaliation to the U.S.’s solar tariffs—a politically-motivated move aimed at punishing farmers in states that voted for Trump.

As Goldman Sachs pointed out in a report this week, **the market has “generally demonstrated no signs of concern” about a trade war.** They use the stock prices of companies with high imported costs of goods sold as evidence:



Source: Business Insider

With the Section 301 investigation set to result in severe measures against China in the coming weeks, we expect that lack of concern to be short-lived. **Trump is not the first president to take issue with and action against China’s IP policies and tech ambitions, but he is the first to think: “trade wars are good, and easily won,”** as he declared on Twitter a few weeks ago. **Now appears the time to prepare for an IP battle that more and more appears inevitable.**



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