

THE U.S.-CHINA TRADE NEGOTIATION: A CONTRACT THEORY PERSPECTIVE

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ABSTRACT

International trade negotiations have traditionally been viewed as a two-level political bargain between trading nations and among domestic interest groups. While this bargaining model is helpful for predicting the political dynamics in trade negotiations, its focus on politics tends to obscure the economic consequences of trade agreements. Drawing upon insights from contract theory in economics, this Article analyzes three ingredients of transaction costs that lead to the incompleteness of a trade agreement—the unforeseen contingencies, the cost of enforcing the contract, and the cost of writing the agreement. Using the Sino-U.S. trade negotiation between 2018 to 2019 as a comprehensive case study, this Article illustrates the circumstances when a trade agreement is difficult to write, unlikely to succeed, and impossible to enforce. As an alternative to a trade agreement, this Article advocates instead for greater economic integration as a commitment device. By allowing each country to hold the other’s assets hostage, economic integration can facilitate cooperation between nations when trust is lacking. This Article contributes to the existing literature by proposing an economic framework to analyze the promise and perils of trade negotiations. It also offers a cautionary tale of using economic sanction to force other countries to make legal concessions.

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I. INTRODUCTION

International trade negotiations have traditionally been perceived as a two-level game: at the international level, trading nations attempt to maximize their national interests while minimizing the adverse consequences from a liberalizing trade agreement; at the domestic level, domestic interest groups lobby for favorable treatments under the trade agreement while politicians seek to strike compromises among different interest groups.¹ Faced with the entanglement of domestic and international affairs, trade representatives strive to reach an agreement that can be ratified at home.² This bargaining model, which focuses on the interaction between international and domestic interests, is helpful for predicting the political dynamics in trade negotiations. Yet the focus on politics tends to obscure the economic consequences of trade agreements. Indeed, if the obligations in the agreement will not be closely observed by the trading countries, or if it is foreseeable that they would fail to enforce the agreements, or if it is difficult to put the agreement down into writing, then any victory with a trade negotiation will prove illusory. Accordingly, the ex post consequences of a trade agreement should be a crucial consideration in an ex ante bargain. This economic perspective, however, is often overlooked by trade lawyers.

Drawing upon insights from contract theory in economics, this Article proposes an economic framework to analyze the promise and

1. Putnam was the first one to propose the two-level game bargaining framework. See Robert D. Putnam, *Diplomacy and Domestic Politics: The Logic of Two-Level Games*, 42 INT'L ORG. 427, 434 (1988). Since Putnam's introduction, the two-level game has become the standard framework to understand international negotiations. See, e.g., Jongryn Mo, *The Logic of Two-Level Games with Endogenous Domestic Coalitions*, 38 J. CONFLICT RESOL. 402, 402-07 (1994); Jongryn Mo, *Domestic Institutions and International Bargaining: The Role of Agent Veto in Two-Level Games*, 89 AM. POL. SCI. REV. 914, 914-15 (1995); Rachel Brewster, *Rule-Based Dispute Resolution in International Trade Law*, 92 VA. L. REV. 251, 262-63 (2006).

2. Putnam, *supra* note 1, at 460.

perils of trade negotiations.³ Oliver Hart, a Nobel Prize-winning economist, has long proposed with his coauthors that the existence of transaction costs makes it impossible for the parties to write a complete contract.⁴ The concept of transaction cost dates back to Ronald Coase's work on the boundary of a firm, in which he explains that firms exist because market transactions could be very costly, considering the costs of finding a transaction partner, negotiating, contracting, and inspection of execution of the contract *inter alia*.⁵ Jean Tirole, another Nobel-winning economist, subsequently identified three types of transaction costs that can lead to contracts' incompleteness: first, unforeseen contingencies—that is, the parties cannot anticipate, in advance, every contingency that will occur *ex post*; second, costs of enforcing the contracts—that is, courts must understand the agreement, verify the contingencies in case they occur, and enforce the contract; and third, costs of writing the contract—that is, even if people expect the contingencies, such contingencies are so numerous that it is costly to write them down.⁶

One illuminating example of how the theory of contract incompleteness can be applied to better understand trade agreements is the U.S.-China trade negotiation between 2018 and 2019. In this trade talk, the Trump administration was not satisfied with China merely purchasing

3. Broadly speaking, contract theory refers to the theory of incentives, information, and economic institutions. See PATRICK BOLTON & MATHIAS DEWATRIPONT, *CONTRACT THEORY* 2 (2004). Economists have applied contract theory to understand the *ex-ante* decision of why and how parties make contractual arrangements. This is different from the legal analysis of contract, which takes an *ex post* perspective by focusing on the consequences of the breach of contract. See ROBERT E. SCOTT & PAUL B. STEPHEN, *THE LIMITS OF LEVIATHAN, CONTRACT THEORY AND THE ENFORCEMENT OF INTERNATIONAL LAW* 62–63 (2009).

4. See generally Sam Grossman & Oliver Hart, *The Costs and Benefits of Ownership: A Theory of Lateral and Vertical Integration*, 94 *J. POL. ECON.* 691 (1986); Oliver Hart & John Moore, *Property Rights and the Nature of the Firm*, 98 *J. POL. ECON.* 1119 (1990); OLIVER HART, *FIRMS, CONTRACTS AND FINANCIAL STRUCTURE* (1995).

5. Ronald Coase first proposed the concept of transaction cost in Ronald H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937). He later elaborated on the concept in Ronald H. Coase, *The Problem of Social Cost*, 3 *J.L. & ECON.* 1, 15 (1960). (“In order to carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on. These operations are often extremely costly, sufficiently costly at any rate to prevent many transactions that would be carried out in a world in which the pricing system worked without cost.”).

6. Jean Tirole, *Incomplete Contract: Where Do We Stand?*, 67 *ECONOMETRICA* 741, 743–44 (1999) (summarizing the literature); see also STEVEN SHAVELL, *FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW* 299–301 (2004) (elaborating on similar reasons for contract incompleteness).

more of its soy beans; it also pressed China to make structural economic changes such as removing subsidies for its state-owned enterprises.⁷ Above all, it demanded that China change its domestic law and practices, specifically intellectual property (IP) laws and cybersecurity laws to eliminate forced technology transfer and stop the theft of U.S. trade secrets to foster indigenous innovation.⁸

In the past, the United States has made similar requests of China to improve its IP legal practices in order to enhance the protection of U.S. businesses.⁹ Yet the United States complains that these bilateral engagements have yielded empty promises from China without any substantial improvement in practice.¹⁰ The U.S. government alleges that Chinese law may, de jure, be in compliance with international rules and standards, but that the de facto practice lags behind.¹¹ The current Trump administration has grown increasingly impatient with China's slack enforcement.¹² The Office of the United States Trade Representative (USTR) has demanded that the trade agreement incorporate more specificities, and that an enforcement mechanism be in place to ensure that China will live up to its promise.¹³ More specifically, the U.S. trade

7. *Statement of the United States Regarding China Talks*, THE WHITE HOUSE (Jan. 31, 2019) <https://www.whitehouse.gov/briefings-statements/statement-united-states-regarding-china-talks/>.

8. *Id.*

9. OFFICE OF THE U.S. TRADE REPRESENTATIVE, FINDINGS INTO THE INVESTIGATION INTO CHINA'S ACTS, POLICIES, AND PRACTICES RELATED TO TECHNOLOGY TRANSFER, INTELLECTUAL PROPERTY, AND INNOVATION UNDER SECTION 301 OF THE TRADE ACT OF 1974 6 (2018) [hereinafter *USTR*]; see also Robert D. Atkinson, Nigel Cory & Stephen Ezell, *Stopping China's Mercantilism: A Doctrine of Constructive, Alliance-Backed Confrontation*, INFO. TECH. & INNOVATION FOUND. 1, 20–23 (2017), http://www2.itif.org/2017-stopping-china-mercantilism.pdf?_ga=2.171401888.1842093318.1593887421-249582046.1593887421.

10. *Hearing on U.S.-China Trade: Hearing Before the H. Comm. on Ways & Means*, 116th Cong. (2019) [hereinafter *Written Statement of Robert E. Lighthizer*] (written statement of Robert E. Lighthizer) <https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/Lighthizer%20testimony.pdf> (“We at USTR are very aware of the history of our trading relationship with China, and the disappointments that have resulted from promises that were not kept.”); see also Alan Rappeport, *19th Century “Humiliation” Haunts China-US Trade Talks*, N.Y. TIMES (Mar. 27, 2019), <https://www.nytimes.com/2019/03/27/us/politics/china-opium-wars-trade-talks.html> (referring to Senator Charles E. Grassley of Iowa’s statement that China had a history of breaking promises on trade).

11. See generally *USTR*, *supra* note 9.

12. *Id.*; see also *Hearing on U.S.-China Trade: Hearing Before the H. Comm. on Ways & Means*, 116th Cong. (2019) [hereinafter *Testimony of Lighthizer*] (written statement of Robert E. Lighthizer), <https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/U.S.-China%20Trade%20Hearing%20Transcript%201.pdf>.

13. See *Testimony of Lighthizer*, *supra* note 12, at 14 (“[O]ur hope is to have specific language on specific issues that is enforceable through a very clear process.”).

negotiators advocated using tariffs as a continuing punitive threat to China, and China cannot retaliate in kind.¹⁴

During the truce in early 2019, China adopted a compromising tactic. Anticipating that the United States would need a continuing monitoring device to ensure its compliance, China took the initiative of amending a few IP-related laws to mollify U.S. concerns when the trade talk was expected to enter the last stage.¹⁵ As was widely reported, the U.S. and Chinese leaderships then reached an agreement in principle in April 2019, but they had significant disagreements when the agreement was put into writing.¹⁶ The U.S. government wanted to include a laundry list of legal provisions that China must amend through the national legislature.¹⁷ China, on the other hand, preferred a flexible contract and was only willing to follow up with the promulgation of less visible government rules and regulations.¹⁸ At the very last minute, China proposed significant changes to the draft of the trade agreement in an attempt to make the agreement less specific.¹⁹ The United States objected strongly to this proposal and the negotiations broke down in early May 2019.²⁰ The row regarding the level of contract specificity directly resulted in an impasse.²¹

In the following discussion, I will apply the analytical framework of contract incompleteness to examine the U.S.-China trade negotiation. As will be explained below, trade agreements, like other contracts, are

14. David Lawder & Susan Heavy, *Trump "Firm" on China Structural Demands, Tariffs Part of Enforcement: Pence*, REUTERS (May 3, 2019), <https://www.reuters.com/article/us-usa-trade-china/trump-firm-on-china-structural-demands-tariffs-part-of-enforcement-pence-idUSKCN1S91DG>; James Politi & Yuan Yang, *US and China Haggles over Enforcement of Trade Commitments*, FIN. TIMES (Mar. 10, 2019), <https://www.ft.com/content/e089b6de-42b4-11e9-b168-96a37d002cd3>.

15. See *infra* Part II(ii).

16. Wendy Wu, Catherine Wong & Orange Wang, *US-China Trade Deal Within Reach If Xi Jinping and Donald Trump Show Courage at the G20 Summit in Osaka*, S. CHINA MORNING POST (June 21, 2019), <https://www.scmp.com/news/china/diplomacy/article/3015422/us-china-trade-deal-within-reach-if-xi-jinping-and-donald> (noting that Craig Allen, president of the US-China Business Council, stated that the top leaders of the two sides "have reached . . . agreement[s] in principle," but it is in the detail that they disagree).

17. Kinling Lo, *What Killed the US-China Trade Talk: A Tale of Two Texts*, S. CHINA MORNING POST (May 16, 2019), <https://www.scmp.com/news/china/diplomacy/article/3010456/what-killed-us-china-trade-talks-tale-two-texts>.

18. *Id.*

19. See Chris Buckley & Keith Bradsher, *How Xi's Last-Minute Switch on U.S.-China Trade Deal Upended It*, N.Y. TIMES (May 17, 2019), <https://www.nytimes.com/2019/05/16/world/asia/trade-xi-jinping-trump-china-united-states.html>.

20. *Id.*

21. *Id.*

incomplete.²² In fact, the rigid agreement that was insisted upon by the Trump administration represents a quintessential example of how transaction costs could pose challenges to the drafting, concluding, and enforcement of a trade agreement. On January 15, 2020, President Trump reached a limited, phase-one deal with China.²³ Yet many thorny issues are outstanding and remain to be resolved in subsequent negotiations.²⁴ This Article predicts that any trade agreement, including the phase-one deal committing China to improve its legal practices, is inherently unstable, and subsequent U.S.-China negotiations for a more comprehensive deal will continue to be met with severe challenges.

The rest of this Article is organized into six parts. Part II recounts the U.S.-China trade negotiation between 2018 and 2019. It provides the backdrop of the trade tension between the two countries, summarizes the legal concessions that China has made prior to the collapse of the trade talk, and describes how the two countries' row with regard to contract specificities resulted in an impasse. Part III explains the unforeseen contingencies that might occur during the execution of the Sino-U.S. trade agreement. It first describes China's astounding success in modernizing its IP laws and institutions over the past few decades. It then explains why the deficiency in law enforcement is difficult to monitor and almost impossible to verify. As will be demonstrated in this Part, many aspects of law enforcement are not contractible, and the Chinese government, particularly the local governments, retain vast discretion in enforcing the laws. As a result, a significant amount of uncertainty may arise when China begins to carry out its obligations under the trade agreement.

Part IV elaborates on the difficulty of enforcing the U.S.-China trade agreement. It first shows that the Trump administration's unilateral trade measures against China represent an attack on the legitimacy and authority of the WTO rules. Therefore, any U.S.-China trade agreement to be concluded will not be governed by international economic rules. It then argues that the agreement is not self-enforcing either. It observes that the U.S. administration is subject to severe political and economic constraints in imposing overtly harsh punishments on China, given the highly complementary economic and trade structures

22. Henri Horn, Giovanni Maggi & Robert W. Staiger, *Trade Agreements as Endogenously Incomplete Contracts*, 100 AM. ECON. REV. 394, 394 (2010). See generally Pierpaolo Battigalli & Maggi Giovanni, *Rigidity, Discretion, and the Costs of Writing Contracts*, 92 AM. ECON. REV. 798 (2002).

23. *President Donald J. Trump Is Signing A Landmark Phase One Trade Agreement with China*, THE WHITE HOUSE, (Jan. 15, 2020), <https://www.whitehouse.gov/briefings-statements/president-donald-j-trump-signing-landmark-phase-one-trade-agreement-china/>.

24. James Politi, *What's in the US-China "Phase One" Trade Deal*, FIN. TIMES (Jan. 16, 2020), <https://www.ft.com/content/a01564ba-37d5-11ea-a6d3-9a26f8c3cba4>.

of the two countries. Moreover, as illustrated by the Sino-U.S. intellectual property rights (IPR) negotiations in the 1990s, U.S. interests and policy toward China are constantly evolving, and these types of bilateral agreements are not renegotiation-proof.

Part V discusses the cost of writing a trade agreement. This part of the analysis builds upon the work of contract theorists, who have demonstrated that concerns about pride and dignity can cause people to reach an impasse in a bargain.²⁵ It explains that the trade war erupted against a backdrop of growing U.S. hostility toward China, and there is an overwhelming consensus among Chinese policymakers that the United States is using trade to contain China's rise. It further shows that a rigid agreement would easily trigger China's historical memory of over a hundred years of colonial rule under the unequal treaties signed with Western powers. As such, capitulating to the United States' demand for a rigid agreement would send a strong signal that China is bowing to the pressures of the United States, leaving an impression that the Chinese government is weak in this situation.

Part VI suggests an alternative to using a trade agreement to bind China to its promises. Based on the economic insights from Nobel laureates Thomas Schelling and Oliver Williamson, this Part explains how hostage-taking can help overcome mistrust and tension between parties and facilitate their cooperation.²⁶ It argues that economic integration is a form of hostage that can help stabilize the U.S.-China commercial relationship. By addressing the Trump's administration's various policy measures to decouple the Chinese and U.S. economies, this Part warns that conflicts will be more likely to arise when the two countries have fewer hostages from each other. Part VII concludes and offers three concrete recommendations for U.S. trade representatives to facilitate their negotiation with their Chinese counterparts.

II. THE ROW OVER CONTRACT SPECIFICITIES

Lawyers and economists have long considered the tradeoffs between rigidity and flexibility in writing a contract.²⁷ A flexible contract allows

25. Ronald Benabou & Jean Tirole, *Over My Dead Body: Bargaining and the Price of Dignity*, 99 AM. ECON. REV.: PAPERS & PROC. 459, 459 (2009). See generally Roland Benabou & Jean Tirole, *Identify, Dignity and Taboos: Beliefs as Assets*, (IZA Inst. of Labor Econ., Discussion Paper No. 2583, 2007).

26. THOMAS C. SCHELLING, *THE STRATEGY OF CONFLICT* 20 (1980); Oliver E. Williamson, *Credible Commitments: Using Hostages to Support Exchange*, 73 AM. ECON. REV. 519, 521–22 (1983).

27. See SCOTT & STEPHEN, *supra* note 3, at 76–79 (noting that the tension between the need for commitment and flexibility influences the parties' decision to contract); Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814, 840–55 (2006) (explaining that the choice between writing vague or precise terms in contracts is determined by

the parties to adjust the outcome to the state of nature whereas a rigid contract does not allow the parties' obligations to be sufficiently contingent on the external state.²⁸ However, a flexible contract raises issues of moral hazard when the promisor adjusts his future performance in a way that best serves his own interest at the expense of the promisee.²⁹ This occurs when the promisor has hidden information from the promisee, or, even if the promisee can observe the action, it is difficult for a third party to verify the action of the promisor.³⁰ As a result, the promisee is deterred from making relationship-specific investments *ex ante*, for fear that they would be vulnerable to exploitation *ex post*.³¹ The solution to the under-investment problem is a rigid agreement, which binds the promisor to his commitments to ensure his credibility.³² This would encourage the parties to undertake relation-specific investments and to take precautions to reduce risk-bearing costs.³³ But a rigid contract has its drawback, as the parties cannot adjust their performance according to the state of the world, leading to *ex post* inefficiencies.³⁴

A similar tradeoff between flexibility and rigidity also exists in the current trade negotiation between China and the United States. While free trade is widely recognized as superior to protectionist policies, countries could engage in "opportunistic protectionism" by failing to

the tradeoff between the front-end transaction cost and back-end enforcement cost); Anne van Aaken, *Between Commitment and Flexibility: The Fragile Stability of the International Investment Protection Regime 1–2* (U. of St. Gallen Law Sch. Law and Econ. Research Paper Series, Working Paper No. 2008-23, 2008) (cautioning that if international investment law continues to place too many constraints on sovereignty without allowing flexibility, it could precipitate a backlash from states).

28. The definition of rigid and flexible contracting is adopted from Oliver Hart & John Moore, *Contracts as Reference Points 1* (Nat'l Bureau of Econ. Research Working Paper Series, Working Paper No. 12706, 2006). Hart and Moore have proposed an alternative and complementary view that contracts can serve as reference points—that is, the parties' feeling of entitlement. *Id.* As people tend to have self-serving biases, the parties to a contract typically hope for the most favorable outcome as allowed by the contract. *Id.* at 8. A flexible agreement could give rise to disagreements between the parties as it allows for multiple outcomes. *Id.* at 6. The party who feels that he is shortchanged can retaliate by shading in performance, causing deadweight loss. Hart calls this "aggrievement cost." *Id.* at 1, 8. A rigid contract, on the other hand, specifies the exact outcome and so parties get what they expect. *Id.* at 1. This reduces shading and aggrievement cost. *Id.* Hart and Moore's model is valid in the absence of non-contractible relationship-specific investments. *Id.*

29. See SCOTT & STEPHEN, *supra* note 3, at 78.

30. *Id.* at 71–72.

31. *Id.* at 76.

32. *Id.*

33. *Id.*

34. *Id.* at 77; see also Hart & Moore, *supra* note 4, at 1122.

abide by the liberalizing trade agreement.³⁵ Indeed, whatever legal concessions that China ultimately makes in a trade agreement will be implemented by the Chinese administrative agencies and judiciary, who enjoy an information advantage to the U.S. government. The information asymmetry between the two sovereigns makes it very difficult for the USTR to closely monitor and verify China's compliance with the trade agreement. The problem of moral hazard could therefore arise when China fails to exert the best efforts to carry out its obligations but rather shirks some of its responsibilities. This explains why the USTR is insisting on a rigid agreement, as it could pin down more precisely the outcome that China needs to deliver. Another reason why the USTR insists upon a rigid contract may have to do with reputation sanction.³⁶ China will be subject to more pressures to comply with a rigid contract as the failure to do so could expose China to condemnation from the international community. However, as will be elaborated below, the two countries' row with regard to contract specificities directly resulted in a negotiation impasse.

A. Backdrop

In August 2017, the Trump Administration launched a Section 301 investigation into China's policies on intellectual property, technology, and innovation.³⁷ One of the most controversial U.S. foreign trade legislations, Section 301 allows the United States to unilaterally impose economic sanctions on imports.³⁸ After the establishment of the WTO

35. Beth V. Yarbrough & Robert M. Yarbrough, *Reciprocity, Bilateralism, Economic "Hostage," Self-Enforcing Agreements in International Trade*, 30 INT'L STUD. Q. 7, 8 (1986); see John A. C. Conybeare, *Public Goods, Prisoners' Dilemmas and the International Political Economy*, 28 INT'L STUD. Q. 5, 10 (1984).

36. In the context of sovereign debts, in which the debtors are largely litigation-proof, parties write long and detailed contracts because they anticipate reputation sanction from third parties such as the IMF. Mitu Gulati & George Triantis, *Contracts Without Law: Sovereign Versus Corporate Debt*, 75 U. CIN. L. REV. 977, 1004 (2007).

37. WAYNE M. MORRISON, CONG. RESEARCH SERV., ENFORCING U.S. TRADE LAW: SECTION 301 AND CHINA 1 (2019). ("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.")

38. See Chad P. Bown, *Rogue 301, Trump to Dust off Another Outdated US Trade Law?*, PETERSON INST. INT'L ECON. (August 3, 2017), <https://www.piie.com/blogs/trade-investment-policy-watch/rogue-301-trump-dust-another-outdated-us-trade-law> ("The US government acted as the police force (identifying the foreign government's crime), prosecutor (making the legal arguments), jury (ruling on the evidence), and judge (sentencing the foreigner to US rehabilitative punishment). And sometimes cases would involve issues without internationally agreed upon

in 1994, which created a new multilateral litigation system to handle trade disputes, Section 301 fell into disuse and the United States instead turned to the WTO's dispute resolution mechanism to resolve disputes.³⁹ Thus, the Trump Administration's decision to invoke the Section 301 investigation against China this time represents a sharp departure from previous practice. Following the conclusion of the 301 investigation, the White House released a "Memorandum on Actions by the United States related to the Section 301 Investigation" on March 22, 2018.⁴⁰ The memo made four major complaints against China, stating that China had: (1) abused administrative approval processes to pressure foreign firms to transfer technology; (2) maintained discriminatory licensing practices to force the transfer of U.S. technology; (3) used state capital to strategically acquire cutting-edge technology and IP assets to support China's industrial policy objectives; and (4) engaged in cyber-intrusion into U.S. networks to steal valuable IP and sensitive business information.⁴¹ With the exception of the third channel on outbound investment, the other three channels all concern China's inadequate protection of IPRs.

The United States has, in the past, relied on bilateral engagements to exert pressures on China to enhance its IP protection.⁴² Before the trade war erupted in 2018, the U.S. and Chinese governments had exchanged views on technology transfer at multiple occasions of formal, high-level dialogues.⁴³ In each round of these talks, China had committed to stop using technology transfer as a condition for market access and allow businesses the freedom to negotiate and decide on

rules."'). See generally AGGRESSIVE UNILATERALISM: AMERICA'S 301 TRADE POLICY AND THE WORLD TRADING SYSTEM (Jagdish Bhagwati & Hugh T. Patrick eds., 1990).

39. Bown, *supra* note 38 ("Between 1974 and now, the US government has conducted 122 Section 301 investigations, but there has been only one new Section 301 investigation since 2001.").

40. Presidential Memorandum on the Actions by the United States related to the Section 301 Investigation, 83 Fed. Reg. 13099 (Mar. 22, 2018), <https://www.govinfo.gov/content/pkg/DCPD-201800180/pdf/DCPD-201800180.pdf>. The hostile U.S. trading policies against China are subject to a storm of criticism. See Stephen Roach, *Why the US Has A Weak Case Against China's 'Unfair' Trade Practices*, S. CHINA MORNING POST (Apr. 26, 2018), <https://www.scmp.com/comment/insight-opinion/article/2143496/why-us-has-weak-case-against-chinas-unfair-trade-practices>.

41. Presidential Memorandum on the Actions by the United States related to the Section 301 Investigation, *supra* note 40.

42. *USTR*, *supra* note 9.

43. *Id.* at 6–8. (including, among others, U.S.-China Joint Commission on Commerce and Trade, the U.S.-China Strategic Economic Dialogue, and a new dialogue known as the U.S.-China Comprehensive Economic Dialogue).

transfer issues voluntarily.⁴⁴ China had further committed to not exert pressures on such technology transfers through regulatory and administrative approval.⁴⁵ But the United States claimed that these dialogues only achieved “isolated, incremental progress” and that the Chinese government had failed to follow through on important commitments.⁴⁶ U.S. businesses complained that, even though China got rid of the formal requirements in its rules and regulations, technology transfer as a quid pro quo remained a de facto requirement.⁴⁷

Frustrated by China’s stalling tactics in annual economic dialogues with their Chinese counterparts, the U.S. trade officials have been pressing for a deal that has teeth in this round of the trade talks.⁴⁸ In February 2019, the Chinese side was prepared to sign a memorandum of understanding (MOU), but U.S. President Donald Trump suddenly demanded a more binding agreement.⁴⁹ More specifically, the USTR wanted to incorporate an enforcement mechanism into the agreement to ensure that China would live up to its promise.⁵⁰ This view is widely shared among many American experts who believe that such an enforcement mechanism is the key to the United States’ success in the trade talks.⁵¹ According to Robert Lighthizer, any complaints about China’s violation of the agreement subsequent to the conclusion of the trade talks will have to be resolved through meetings with high-level

44. *Id.*

45. *Id.*

46. OFFICE OF THE U.S. TRADE REPRESENTATIVE, 2018 REPORT TO CONGRESS ON CHINA’S WTO COMPLIANCE 50 (2019) [hereinafter *USTR 2018 Report*]; see also *Testimony of Lighthizer*, *supra* note 12 (“We at USTR are very aware of the history of our trading relationship with China, and the disappointments that have resulted from promises that were not kept.”).

47. *USTR*, *supra* note 9, at 22.

48. Michael Martina, *As Trade Talk Reaches Endgame, U.S.-China Ties Could Hinge on Enforcement*, REUTERS (Apr. 29, 2019), <https://www.reuters.com/article/us-usa-trade-china-analysis/as-trade-talks-reach-endgame-u-s-china-ties-could-hinge-on-enforcement-idUSKCN1S50DE>.

49. Kristin Huang & Lee Jeong-Ho, *US Accused of Undermining Trade Talks by Demanding “Hundreds” of Changes to Chinese Law*, S. CHINA MORNING POST (June 11, 2019), <https://www.scmp.com/news/china/diplomacy/article/3014057/us-accused-undermining-trade-talks-demanding-hundreds-changes>.

50. Politi & Yang, *supra* note 14.

51. Huileng Tan, *US Chamber of Commerce: China Trade Deal “Fails” If Washington Doesn’t Win Enforcement Measures*, CNBC (Feb. 18, 2019), <https://www.cnbc.com/2019/02/19/us-china-tradewar-deal-needs-enforcement-says-chamber-of-commerce.html>; see also Martina, *supra* note 48; Huang & Jeong-Ho, *supra* note 49; Josh Rogin, *Trump Is Headed for A Bad Trade Deal that China Won’t Honor*, WASH. POST (Feb. 27, 2019), https://www.washingtonpost.com/opinions/2019/02/27/trump-is-headed-bad-trade-deal-that-china-wont-honor/?utm_term=.332c98f724b.

officials.⁵² If those complaints are not handled in a satisfactory manner, the United States can unilaterally take “proportional” actions against China, such as reviving the threat of tariffs.⁵³ What Mr. Lighthizer envisions is a close monitoring system based on complaints from U.S. businesses operating in China, where tariffs are used as a continuing deterrence device. He also emphasizes explicitly incorporating such an enforcement mechanism into the trade agreement to ensure that China will live up to its promise.⁵⁴

B. *China’s Legal Concessions*

In anticipation of the United States’ demand for a credible commitment, China made a number of concessions by quickly and preemptively amending some of its IP-related laws between March and April 2019 to directly address U.S. concerns. As elaborated below, these amendments largely conform to the broad contours of the U.S. demands, although there remain important areas of the law in which China has not taken action.⁵⁵

52. *Testimony of Lighthizer*, *supra* note 12, at 52–53 (“If we have an agreement there will be a process that has been agreed to where, at the office-director level, there will be monthly meetings, and then I will go through the process and then I will take a step back. At the vice-ministerial level there will be quarterly meetings. And then there will be semi-annual meetings at the ministerial level. That would be me and the vice premiere, who is my counterpart in this. And the idea is two things: one, individual companies will come to us with complaints about practices, and we will be able to work those through the process. In many cases, those are going to have to be anonymous, because companies are afraid to come forward, because they know what will happen if they do . . . and then, in addition to that, there will be systemic problems, where we will see patterns developing, and a series of things that we disagree with, and we will bring those through the process. Hopefully, in most cases, they will be resolved at the first or second level. If not, they will be resolved at my level. And if there is disagreement on my level, then the United States would expect to act proportionally, but unilaterally, to insist on enforcement.”).

53. *Id.* at 53.

54. *Id.* at 52–53.

55. China has not changed the patent law, an area in which the United States has demanded a heavier penalty on infringements and a stricter law to prevent forced technology transfer. Moreover, the Trump administration wants China to modify its cybersecurity law to ease its concern about data theft. *See* Buckley & Bradsher, *supra* note 19. Since China promulgated its cybersecurity law on June 1, 2017, the United States has been concerned that the law could be pretext for China to steal sensitive data from US businesses. *See* U.S. TRADE REPRESENTATIVE, 2018 SPECIAL 301 REPORT 45 (2018) [hereinafter *USTR 2018 Special 301 Report*] (stating that the USTR was concerned that the law requires that the sellers of various IP-intensive industries disclose sensitive IP to government authorities, and may require such IP rights be owned in China, and that the relevant research and development be conducted in China to address purported security concerns and that the law also restricts or even bans cross-border data flows, making it difficult for US industries who rely on cloud computing platforms for global service delivery).

On March 15, 2019, China passed its Foreign Investment Law, only three months from the publication of the draft rules.⁵⁶ The speed in passing the law was unprecedented, as a new law normally goes through at least several rounds of public comment and takes years before approval.⁵⁷ With only forty-one provisions, the new law is a much curtailed version of a previous draft circulated in 2015, containing more than 170 provisions.⁵⁸ The new law replaces the existing three foreign investment laws that were passed in the early years of China's opening reform.⁵⁹ It aims to facilitate and promote foreign investments, and to level the playing field for foreign and domestic investors in China.⁶⁰ First, it streamlines governmental approvals and enhances the approval efficiency.⁶¹ Second, it includes stronger language on protecting foreign firms' IPs.⁶² Third, it explicitly prohibits governmental departments from coercing foreign companies to transfer technologies and bans Chinese officials from divulging commercial secrets.⁶³ The new language also tries to tackle China's opaque regulatory review process, also known as "conformity assessments," that foreign companies must complete before manufacturing new products or setting up plants in

56. Zhonghua Renmin Gongheguo Waishangtouzi Fa (中华人民共和国外商投资法) [Foreign Investment Law of the People's Republic of China] (promulgated by the 13th Nat'l People's Cong., Mar. 15, 2019, effective Jan. 1, 2020) 2019 ORDER OF THE STATE COUNCIL 723 (China); see Liwei Wang, Zhang Yu, Shan Yuxiao & Teng Jing Xuan, *In Depth: New Foreign Investment Law Goes on Fast Track*, CAIXIN (March 11, 2019), <https://www.caixinglobal.com/2019-03-11/in-depth-new-foreign-investment-law-goes-on-fast-track-101390458.html> (stating that the draft rules were published on the official website of the Standing Committee of the National People's Congress of the People's Republic of China on Dec. 26, 2018 and the public consultation ended on Feb. 24, 2019).

57. Wang, Zhang, Shan & Teng, *supra* note 56; see also Zhou Xin, *China's New Foreign Investment Law Is Too Vague, Says US Business Group*, S. CHINA MORNING POST (Mar. 13, 2019), <https://www.scmp.com/economy/china-economy/article/3001577/chinas-new-foreign-investment-law-too-vague-says-us-business>.

58. Xin, *supra* note 57; see also Lim Yan Liang, *China's Draft Foreign Investment Law: Too Little, Too Fast, Says Critics*, STRAITS TIMES (Mar. 8, 2015), <https://www.straitstimes.com/asia/east-asia/china-says-new-foreign-investment-law-to-foster-fair-competition> (noting that the 2015 draft rules were stalled in the National People's Congress and never went into force).

59. Liang, *supra* note 58. The existing foreign investment laws include the Sino-Foreign Equity Joint Venture Law, the Sino-Foreign Contractual Joint Venture Law, and the Foreign Invested Enterprise Law.

60. Zhonghua Renmin Gongheguo Waishangtouzi Fa (中华人民共和国外商投资法) [Foreign Investment Law of the People's Republic of China] (promulgated by the 13th Nat'l People's Cong., Mar. 15, 2019, effective Jan. 1, 2020) 2019 ORDER OF THE STATE COUNCIL 723 (China).

61. *Id.* art. 19.

62. *Id.* art. 22 (replacing a phrase about encouraging technology cooperation based on voluntary principles and commercial laws in the previous draft).

63. *Id.* arts. 22–23.

China.⁶⁴ However, the new foreign investment law only sets out a blueprint and does not specify clear operational details, leaving them to be addressed by further implantation guidelines.⁶⁵ The response from foreign businesses was lukewarm at best, noting that the law, passed without sufficient consultation, had failed to go into the specifics of the issues that were challenging foreign businesses.⁶⁶ Others expressed concern that the broad and vague terms in the new law would leave room for discretionary implementation of the law.⁶⁷

On March 18, 2019, China abolished several highly controversial provisions in the State Council's 2002 Technology Import and Export Regulation, and the Sino-Foreign Equity Joint Venture Law Implementing Regulations.⁶⁸ These regulations used to impose contractual restrictions on the licensing of foreign technology into China by requiring mandatory indemnities against third party infringement and mandatory ownership of improvement by domestic licensees, as well as forcing technology transfer where the foreign investor chooses to license the technology to the joint venture.⁶⁹ The United States had repeatedly urged the Chinese government to revise these provisions to no avail and even challenged these regulations at the WTO.⁷⁰ China's abolition of these provisions thus seems to directly address the United States' longstanding concern about these regulations. As a complement to the Foreign Investment Law, on April 23, 2019, China amended the Administrative Licensing Law to tackle the issues of forced technology transfer during administrative approval and licensing.⁷¹

64. *Id.* arts. 24–25.

65. Amanda Lee, *Chinese Premier Li Keqiang Says Foreign Investment Law Shows Beijing Is Serious about Opening Economy Further*, S. CHINA MORNING POST (Mar. 15, 2019), <https://www.scmp.com/economy/china-economy/article/3001926/chinese-premier-li-keqiang-says-foreign-investment-law-shows> (explaining the law is only a basic law and the State Council will introduce further implementation guidelines, according to Premier Li Keqiang at a press conference).

66. See Xin, *supra* note 57; see also Liang, *supra* note 58.

67. See Liang, *supra* note 58.

68. See *China Breaks New Ground with Foreign Investment Law-Related Intellectual Property Reform*, HOGAN LOVELLS (Apr. 23, 2019), <https://www.engage.hoganlovells.com/knowledgeservices/viewContent.action?key=Ec8teaJ9VarMMm3vQ0dgfa%2FdwZ0I6NkpBiaRvcQ1%2B0trYQ6QELAnKE%2BuQ3%2BHDx%2BwtQYOTEw3eMk%3D&nav=FRbANEucS95NMLRN47z%2BeeOgEF Ct8EGQ0qFfoEM4UR4%3D&emailtofriendview=true&freeviewlink=true>.

69. *USTR 2018 Report*, *supra* note 46, at 133 (noting that no similar requirements are imposed among license agreements between two domestic enterprises or upon an exporting Chinese firm).

70. *Id.*; see also *USTR*, *supra* note 9, at 48–61.

71. See *Zhonghua Renmin Gongheguo Xingzhengxuke Fa* (中华人民共和国行政许可法) [Administrative Licensing Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2003, rev'd. Apr. 23, 2019, effective July 1, 2004) arts. 5, 31,

In addition to technology transfer, the Chinese legislature also made drastic legal changes to address the United States' concern about trade secret protection. Trade secret protection has been a top priority for the United States during rounds of Sino-U.S. bilateral exchange.⁷² The main legislation on trade secrets is found in the Anti-Unfair Competition Law (AUCL), which was amended in November 2017 and became effective on January 1, 2018.⁷³ However, the United States was not satisfied with the 2017 amendments, noting several impediments for claimants in launching suits in the Chinese courts.⁷⁴ The United States also pointed out that the 2017 amendment failed to address obstacles to injunctive relief and the need to allow for evidentiary burden shifting in appropriate circumstances.⁷⁵

On April 23, 2019, the Standing Committee of the National People's Congress promulgated the amendments to the AUCL and the Trademark Law. Since the AUCL had only been amended a year ago, the new amendment was widely recognized as a move to satisfy the U.S. demand to step up protection of business secrets for foreign companies operating in China.⁷⁶ The amendment broadened the scope of trade secrets, which not only relate to technology and business information, but also other commercial information.⁷⁷ Moreover, it clarified the

2019, 2003 PRESIDENTIAL ORDER 7 (China); *see also* Dan Prudhomme, *Reform of China's "Forced" Technology Transfer Policies*, OXFORD BUS. L. BLOG (July 22, 2019), <https://www.law.ox.ac.uk/business-law-blog/blog/2019/07/reform-chinas-forced-technology-transfer-policies> (noting that the revised Administrative Licensing Law prohibits individuals involved in the administrative licensing process from disclosing applicants' trade secrets or other confidential information except under exceptional circumstances; allowing the applicants to object to the sharing of confidential information under such exceptions; prohibiting government agencies from making technology transfer as a condition for licensing).

72. *USTR 2018 Report*, *supra* note 46, at 37.

73. Zhonghua Renmin Gongheguo Fanbuzhengdangjingzheng Fa (中华人民共和国反不正当竞争法) [Anti-Unfair Competition Law of the People's Republic of China] (promulgated by the Standing Comm. of the Nat'l People's Cong., Sept. 2, 1993, rev'd. Apr. 23, 2019, effective Dec. 1, 1993) 1993 PRESIDENTIAL ORDER 10 (China).

74. *Id.* art. 9 (explaining that for instance, the definition of trade secrets is so narrow that it could potentially exclude certain types of proprietary information from its scope of protection; that the protection of trade secrets was only afforded to business entities engaged in commercial activities rather than any natural or legal persons; and that the law fails to provide a higher sanction for willful infringement).

75. OFFICE OF THE U.S. TRADE REPRESENTATIVE, EXEC. OFFICE OF THE PRESIDENT, 2019 SPECIAL 301 REPORT 42 (2019).

76. *Lightning Fast IP Reform in China: Trademark Law and Anti-Unfair Competition Law Amended*, HOGAN LOVELLS (May 2019), <https://perma.cc/7PW8-8X6B>.

77. Zhonghua Renmin Gongheguo Fanbuzhengdangjingzheng Fa (中华人民共和国反不正当竞争法) [Anti-Unfair Competition Law of the People's Republic of China] (promulgated by the

scope of infringers.⁷⁸ The new AUCL also greatly alleviated the burden for plaintiffs to bring suits in the Chinese court.⁷⁹ This is deemed a significant change to the existing law, as it is often very difficult for plaintiffs to obtain conclusive evidence of infringement in trade secret cases.⁸⁰ Some practitioners have pointed out that this requirement is too onerous for the defendants and indeed has gone to the other extreme.⁸¹ Lastly, the new law set forth a punitive damage, allowing the court to impose up to five times the amount of the actual damages or profits obtained by the infringer if damages cannot be ascertained.⁸² It also increased the statutory compensation in case of unascertainable damages from RMB three million to RMB five million.⁸³ All these new amendments seem to have been made to satisfy the U.S. demands.

Another major change is the amendment of the Trademark Law. For years, U.S. businesses have complained that they are subject to malicious legal challenges by third parties whose registered trademarks are

Standing Comm. of the Nat'l People's Cong., Sept. 2, 1993, rev'd. Apr. 23, 2019, effective Dec. 1, 1993) art. 9, 1993 PRESIDENTIAL ORDER 10 (China).

78. *Id.* In the pre-existing regime, individuals were excluded from the scope of infringers; the new amendment makes it possible to hold individuals who facilitate trade secret infringements, such as employees or ex-employees, liable if they were found to have disclosed the trade secrets of the business.

79. Zhonghua Renmin Gongheguo Fanbuzhengdangjingzheng Fa (中华人民共和国反不正当竞争法) [Anti-Unfair Competition Law of the People's Republic of China] (promulgated by the Standing Comm. of the Nat'l People's Cong., Sept. 2, 1993, rev'd. Apr. 23, 2019, effective Dec. 1, 1993) art. 32, 1993 PRESIDENTIAL ORDER 10 (China) (instead of requiring the trade secret owners to demonstrate that the alleged infringer has had access to the trade secret and that the information used by the infringer is substantively the same as the trade secret, the new law providing that the right owner proves that it has taken confidentiality measures to protect the trade secret and that the trade secret has been infringed and the burden of proof will also be shifted if the plaintiff can show that the defendant has ways to obtain the trade secrets and the information used by the defendant is substantially the same, or if the plaintiff has evidence that the defendant has used or is about to use the trade secrets).

80. Ruixue Ran, Sheng Huang, Robert Williams & Andrew Wang, *Trade Secret Protection Is Getting Stronger in China*, LAW 360 (May 23, 2019), https://www.cov.com/-/media/files/corporate/publications/2019/05/trade_secret_protection_is_getting_stronger_in_china.pdf.

81. Author's Interview with A Senior Judge in China (Apr. 2019) (noting that a more reasonable request would be for the defendant to show that he has not had access to the trade secrets and that he has obtained the information independently).

82. Zhonghua Renmin Gongheguo Fanbuzhengdangjingzheng Fa (中华人民共和国反不正当竞争法) [Anti-Unfair Competition Law of the People's Republic of China] (promulgated by the Standing Comm. of the Nat'l People's Cong., Sept. 2, 1993, rev'd. Apr. 23, 2019, effective Dec. 1, 1993) art. 21, 1993 PRESIDENTIAL ORDER 10 (China).

83. *Id.*

identical or closely similar to those of the existing U.S. brands.⁸⁴ China amended its Trademark Law in 2013 and specifically added a provision to combat bad-faith trademark filing.⁸⁵ However, it did not seem to be effective, as the number of bad-faith filings had gone up and owners of such bad-faith marks had become more aggressive.⁸⁶ On April 23, 2019, the same day China released the amendment for AUCL, China amended its Trademark Law, in a clear attempt to address the United States' concern about bad-faith trademark hoarding.⁸⁷ The latest amendment authorizes the trademark office to take a proactive measure to reject bad-faith trademark applications during the examination stage.⁸⁸ Moreover, the new law explicitly prohibits trademark agencies from facilitating bad-faith trademark filings, and punishes malicious trademark litigants.⁸⁹ Similar to the AUCL, the new law significantly increases the statutory compensation and allows courts to award punitive damage.⁹⁰

The lightning speed at which the Chinese government rushed through the legislative changes and the amendments being specifically directed to address concerns expressed by the U.S. administration demonstrate that they were strategically implemented to mollify U.S. concerns. They also seem to be a stone that kills two birds: first, these legal concessions send a signal to the U.S. negotiators that China is willing to commit to address U.S. concerns over inadequate IP enforcement; and second, since these provisions have already been amended, they will not be incorporated into the trade agreement, thus it will be “face-

84. *USTR 2018 Report*, *supra* note 46, at 134 (showing that these Chinese parties filed lawsuits using squatted trademarks to extract exorbitant license fees or to force settlements of unreasonably high prices).

85. *Id.*

86. *Id.*

87. *Zhonghua Renmin Gongheguo Shangbiao Fa (中华人民共和国商标法)* [Trademark Law of the People's Republic of China] (promulgated by the Standing Comm. of the Nat'l People's Cong., Aug. 23, 1982, rev'd. Apr. 23, 2019, effective Mar. 1, 1983) P.R.C LAWS (China), <http://www.npc.gov.cn/npc/c30834/201905/dacf65ecec798444e821a1e06a347f3ee.shtml>.

88. *Id.* art. 4.

89. *Id.* art. 19.

90. *Id.* art. 63 (showing that the new law significantly increases the statutory compensation to RMB 5 million and allows courts to award a punitive damage up to five times the loss incurred by the trademark owners or profits of the infringers and explicitly provides that these goods, and all moulds and materials used for production, be destroyed at the request of the trademark owner to prevent counterfeit goods from being put back into commercial circulation once the trademarks are removed).

saving” for the Chinese government.⁹¹ Among the changes that have been made, the most significant are the provisions strengthening the protection of trade secrets and the trademark law. These provisions have made it easier for foreign businesses to obtain legal relief in China and shall greatly enhance private enforcement in these areas. In fact, some have expressed concern that in some places, the amendments may have gone to the other extreme. However, the other provisions involving technology transfer, particularly those involving public administrative authorities, are vague. It is understandable that foreign businesses are doubtful that these provisions will result in substantive improvement in practice. As will be elaborated in Part III (B) below, it is very difficult, if not impossible, to verify the action of the administrative enforcement.

C. *The Impasse*

The spate of legal concessions that China made during the period of March to April of 2019 appears to be helpful in facilitating the trade talks.⁹² In late April 2019, both the U.S. and Chinese trade representatives cited progress in issues related to IP protection and forced technology transfer, and that they were approaching the final leg of the trade talks.⁹³ However, the two sides had a severe disagreement regarding the details to be incorporated into the final agreement.⁹⁴ The United States wanted the agreement to look hawkish, inserting as many details as possible, including the reservation of the rights to impose future tariffs.⁹⁵ With the presidential reelection approaching in 2020, the Trump administration wanted to claim a victory from the trade deal.⁹⁶ The USTR reportedly had demanded “enormous, even hundreds”

91. Keith Bradsher & Ana Swanson, *Trump's Trade War Threat Poses Problems for China and Investors*, N.Y. TIMES (May 6, 2019), <https://www.nytimes.com/2019/05/06/business/china-trump-trade-economy-markets.html>.

92. Martina, *supra* note 48.

93. *Id.*; see also Lingling Wei, Vivian Salama, Michael C. Bender & Bob Davis, *Frustration, Miscalculation: Inside the U.S.-China Trade Impasse*, WALL STREET J. (May 13, 2019), <https://www.wsj.com/articles/frustration-miscalculation-inside-the-u-s-china-trade-impasse-11557692301> (quoting Mr. Mnuchin as saying that “[w]e were in the process of planning for a signing summit with President Trump and President Xi upon the completion of this agreement” and stating that according to the Trump aides, “one of the issues was where to hold the celebratory moment: Washington or Mr. Trump’s golf estates in Mar-a-Lago, in Florida or Bedminster, N.J.”).

94. Lo, *supra* note 17.

95. *Id.*

96. *Id.*

of changes to Chinese laws to protect IPRs.⁹⁷ In order to bind China to its promise, the USTR demanded that these legislative changes be passed through China's national legislature.⁹⁸ The U.S. insistence on the codification of law through national legislature is a means for the United States to more credibly bind China to its commitments. For a commitment to be credible, the promise must be irreversible and observable to the other player.⁹⁹ Since national laws are implemented by many actors, including the various administrative agencies and the judiciary at both the local and central levels, it would be more difficult for China to renege on such commitments.¹⁰⁰

China rebutted.¹⁰¹ As it asserted in the White Paper: "the more the U.S. government is offered, the more it wants."¹⁰² The Chinese side did not want to reveal the details of the agreement, and was particularly sensitive to wording that may suggest that the United States was dictating these terms to China.¹⁰³ The Chinese negotiators instead wanted any proposed legal concessions to be executed through regulatory and administrative actions rather than through changes made by the

97. Huang & Jeong-Ho, *supra* note 49 (stating that according to Shi Yinghong, a prominent international relations expert from Renming University, the United States' demand to make hundreds of changes to Chinese law was one of the key factors leading to the collapse of the trade talk); *see also* *Testimony of Lighthizer*, *supra* note 12, at 31 (showing Mr. Lighthizer's testimony before the Committee on Ways and Means of U.S. House Committee of Representatives: "if we have an agreement, the IP section alone will be about 27 or 28 pages. It is going to be—this is long, detailed."); Humeyra Pamuk & Ben Blanchard, *China Defiant Towards U.S. on Trade*, *Kudlow Urges Strong Enforcement Step*, STAR ONLINE (May 13, 2019), <https://www.thestar.com.my/news/world/2019/05/13/us-and-china-at-impasse-over-trade-kudlow-says-new-tariffs-will-remain> (quoting White House economic adviser Larry Kudlow: "[w]e would like to see these corrections in an agreement which is codified by law in China, not just a State Council announcement. We need to see something much clearer").

98. Huang & Jeong-Ho, *supra* note 49.

99. AVINASH K. DIXIT, SUSAN SKEATH & DAVID H. REILEY JR., *GAMES OF STRATEGY* 349 (4th ed. 2015).

100. James D. Morrow, *The Strategic Setting of Choices: Signaling, Commitment, and Negotiation in International Politics*, in *STRATEGIC CHOICE AND INTERNATIONAL RELATIONS* 77, 93 (David A. Lake & Robert Powell eds., 1999).

101. According to Larry Kudlow, the sticking point was Beijing's reluctance to put into law changes that had been agreed upon. Pamuk & Blanchard, *supra* note 97.

102. The State Council Information Office of the People's Republic of China, *China's Position on the China-US Economics and Trade Consultations 11 (2019)* ("Resorting to intimidation and coercion, [the US government] persisted with exorbitant demands, maintained the additional tariffs imposed since the friction began, and insisted on including mandatory requirements concerning China's sovereign affairs in the deal, which only served to delay the resolution of remaining difference.").

103. Lo, *supra* note 17.

Chinese legislature.¹⁰⁴ According to people who were privy to the negotiation, Mr. Xi had demanded a substantial recast of the draft trade agreement by May 1, 2019.¹⁰⁵ As a consequence, the 150-page draft trade agreement was riddled with track changes from the Chinese side and China deleted its commitments to change law to resolve the complaints from the United States such as IP theft and trade secrets, forced technology transfer, competition policy, access to financial services, and currency manipulation.¹⁰⁶

The other major sticking point is the enforcement mechanism, particularly the timeline for lifting the tariffs. One suggestion was for the United States to reserve the option to impose the tariffs unilaterally without China's retaliation.¹⁰⁷ Some in the United States have hoped that such a one-sided outcome-based measure to ensure China's compliance will serve as an example of a new methodology of dealing with the differences with China.¹⁰⁸ The Chinese government strongly objected to such a proposal. Wang Shouwen, China's vice-minister of the Ministry of Commerce, noted that any enforcement mechanism should be "two-way, fair, and equal" and China should be allowed to retaliate with tariffs if the United States is overreacting.¹⁰⁹ The Chinese government also insisted upon the removal of all the trade tariffs that the two countries have previously imposed on each other as a

104. Wei, Salama, Bender & Davis, *supra* note 93 (noting that the Chinese do not want to commit to changing laws, objected to publishing all details of the agreement, and preferred a summary instead).

105. Buckley & Bradsher, *supra* note 19.

106. *Id.*; see also David Lawder, Jeff Mason & Michael Martina, *Exclusive: China Backtracked on Almost All Aspects of U.S. Trade Deal-Sources*, REUTERS (May 8, 2019), <https://www.reuters.com/article/us-usa-trade-china-backtracking-exclusiv/exclusive-china-backtracked-on-almost-all-aspects-of-u-s-trade-deal-sources-idUSKCN1SE0WJ>.

107. *Testimony of Lighthizer*, *supra* note 12; see also Amitrajeet A. Batabyal, *The Bigger Underlying Issue of the US-China Trade War May Be Insoluble*, GLOBAL POST (July 23, 2019), <https://theglobepost.com/2019/07/23/us-china-trade/>.

108. Martina, *supra* note 48 (quoting Stratford, a lawyer and former assistant U.S. Trade Representative who has worked in China for more than three decades: "[t]he deal doesn't need to revamp China's economy. But it does need to provide a new methodology for dealing with our differences").

109. Miao Han & James Mayger, *China Warns U.S. That Trade Deal Enforcement Must Be "Two-Way"*, BLOOMBERG NEWS (Mar. 9, 2019), <https://www.bloomberg.com/news/articles/2019-03-09/china-warns-u-s-that-trade-deal-enforcement-must-be-two-way>; see also Huang & Jeong-Ho, *supra* note 49 (State Council advisor Shi Yinong commenting that China could only agree to a "relatively weak enforcement mechanism" without too much scrutiny, and that China would not agree to an enforcement mechanism where it could be subject to automatic penalty for violating the agreement).

precondition to concluding the trade deal.¹¹⁰ The disagreement with regard to contract specificities thus resulted in significant tension between the two parties and the two sides reached an impasse. As Shi Yinhong puts it: “From early May, China has begun to think no deal might be better than a bad deal, and right now China and U.S. have fundamentally contradictory attitudes as to what would be a good deal.”¹¹¹

This Article argues that the U.S. trade negotiators overestimated the benefits of a rigid trade agreement while underestimating its cost. In weighing the costs and benefits of a rigid trade agreement, it is important to recognize the incomplete nature of contracts. As will be elaborated in Parts III to V, the unforeseen contingencies, the difficulty of enforcing the trade agreement, as well as the cost of writing the trade agreement, have all worked together to render a rigid trade agreement highly incomplete.

III. THE UNFORESEEN CONTINGENCIES

Any trade agreement reached by the United States and China will have a part that is more observable and easier to monitor, and a part that is less so. On the surface, Chinese IP laws have achieved significant progress, both in terms of form and substance.¹¹² However, U.S. businesses continue to voice significant complaints and objections to the Chinese practice, reporting that the *de facto* legal practice has not actually improved.¹¹³ Indeed, even if the United States pins down the exact legal provision that China needs to amend and the specific procedure that China needs to change, there will inevitably be many aspects of the law enforcement that are not contractible. As such, there remain many legal and extralegal channels through which the government can obviate the U.S. demand. Importantly, as much of the enforcement power has been delegated to the local governments, the local governments possess vast discretion in deciding on how to enforce the laws, despite the formal laws and procedures that have been prescribed by the central government.¹¹⁴ In the 1990s the United States repeatedly threatened China with trade sanctions and pressured it to provide more adequate IPR protection for U.S. businesses.¹¹⁵ After intense and

110. Politi & Yang, *supra* note 14.

111. Huang & Jeong-Ho, *supra* note 49.

112. *See infra* Part (III) (A).

113. *See infra* Part (III) (B).

114. *See infra* Part (III) (C).

115. *See infra* Part (III) (C).

protracted negotiations, China offered extraordinary concessions, culminating in three rigid trade agreements with the United States.¹¹⁶ However, as will be elaborated below, although these agreements were successful in helping China transform its IP law regime, China has largely failed to follow through with enforcement.

A. *China's Visible Legal Improvement*

Chinese legal scholars have observed a perplexing dual legal system in Chinese law.¹¹⁷ On the one hand, the CCP has maintained, and in recent years, strengthened its control over every apparatus of the Chinese society, usually through substantively extra-legal methods.¹¹⁸ On the other hand, there exists a normal legal system that provides the basic legal infrastructure governing economic transactions.¹¹⁹ As Fu succinctly observes: "In solving ordinary cases related to the bread-and-butter issues of ordinary people, the court operates in a large realm of freedom within the parameters set by the Party while factoring political considerations into the exercise of judicial discretion."¹²⁰ Indeed, despite the bitter complaints from U.S. businesses about inadequate IP protection, China has made significant progress in modernizing and enforcing its IP laws in the past three decades.¹²¹ Such progress, to a great extent, has to do with the exogenous pressures from the U.S. government.¹²² From 1992 to 1996, the United States and China entered into three bilateral agreements on IPR protection.¹²³ These trade

116. See *infra* Part (III)(C).

117. Hualing Fu, *Duality and China's Struggle for Legal Autonomy*, 1 CHINA PERSP. 3 (2019); see also ALBERT H. Y. CHEN, AN INTRODUCTION TO THE CHINESE LEGAL SYSTEM (45th ed. 2019); KAI HANG NG & XIN HE, EMBEDDED COURTS: JUDICIAL DECISION-MAKING IN CHINA (2017); RANDALL PEERENBOOM, CHINA'S LONG MARCH TOWARD RULE OF LAW (2009).

118. Fu, *supra* note 117, at 3.

119. *Id.*

120. *Id.*

121. Joseph A. Massey, *The Emperor Is Far Away: China's Enforcement of Intellectual Property Rights Protection, 1986-2006*, 7 CHI. J. INT'L L. 231, 231-36 (2006) (providing an overview of the developments of Chinese IP laws and enforcement since 1980s).

122. This point, however, is not without controversy. Although the United States argues that foreign pressures, particularly those from the United States, were crucial in pushing China to develop its IP laws, the Chinese officials believe that Chinese developments occurred independently of these pressures. See ANDREW C. MERTHA, THE POLITICS OF PIRACY, INTELLECTUAL PROPERTY IN CONTEMPORARY CHINA 3 (2005).

123. See Massey, *supra* note 121 (providing a chronology of China's IP law development since 1989). The three agreements that were signed during this period include: Memorandum of Understanding, U.S.-China, Jan. 17, 1992, TIAS No. 12,036 [hereinafter 1992 Agreement]; Agreement Regarding Intellectual Property Rights, U.S.-China, Feb. 26, 1995, 34 ILM 881

agreements greatly accelerated Chinese legislative efforts of amending a series of IP laws and regulations, and facilitated the overhaul of the legal institutional support for law enforcement.¹²⁴ On the heels of China's accession to the WTO, China further revamped its entire IP legal regime and introduced a series of implementation guidelines, administrative rules, and judicial interpretations.¹²⁵

Today, China's IP enforcement is typical of a developing, middle-income nation.¹²⁶ In the 2018 International IP index released by the U.S. Chamber of Commerce, China is ranked twenty-fifth out of fifty major trading nations of the United States in terms of its protection of IP rights.¹²⁷ China is ranked immediately behind Malaysia but before other major trading countries such as Turkey, Columbia, Chile, and Russia.¹²⁸ In the past decade, China's payments of licensing fees and royalties for the use of foreign technology have been steadily increasing, and reached almost \$30 billion in 2017, a four-fold increase compared with 2007.¹²⁹ In 2017, China ranked fourth in the amount of royalty payments to foreign countries, just immediately after the United States.¹³⁰ Chinese payments for the use of U.S. IPs also soared significantly to \$8.3 billion in 2017, with its payments growing faster than its GDP.¹³¹

[hereinafter 1995 Agreement]; People's Republic of China Implementation of the 1995 Intellectual Property Rights Agreement-1996, U.S.-China, June 17, 1996, Dep't of Commerce [hereinafter 1996 Agreement].

124. Peter K. Yu, *From Pirates to Partners: Protecting Intellectual Property in China in the Twenty-First Century*, 50 AM. U. L. REV. 131, 133–54 (2000); see also MERTHA, *supra* note 122, at 41–46.

125. Peter K. Yu, *From Pirates to Partners (Episode II): Protecting Intellectual Property in Post-WTO China*, 55 AM. U. L. REV. 901, 906–07 (2006).

126. Daniel Griswold & Donald J. Boudreaux, *How the United States Should Respond to China's Intellectual Property Practices*, MERCATUS.ORG (Apr. 2019), https://www.mercatus.org/system/files/griswold_and_boudreaux_-_policy_brief_-_how_should_the_united_states_respond_to_chinas_intellectual-property_practices_-_v1.pdf.

127. *U.S. Chamber International IP Index*, GLOBAL INNOVATION POL'Y CTR. (Feb. 2019), <https://www.theglobalipcenter.com/ipindex2019-chart/>; see also Chamber of Commerce of the United States of America, *U.S. Chamber Releases 2019 International IP Index* (Feb. 7, 2019), <https://www.uschamber.com/press-release/us-chamber-releases-2019-international-ip-index>.

128. *U.S. Chamber International IP Index*, GLOBAL INNOVATION POL'Y CTR. (Feb. 2019), <https://www.theglobalipcenter.com/ipindex2019-chart/>.

129. Nicolas R. Lardy, *China: Forced Technology Transfer and Theft*, PETERSON INTS. INT'L ECON., (Apr. 20, 2018), <https://www.piie.com/blogs/china-economic-watch/china-forced-technology-transfer-and-theft>.

130. *Id.* (citing data from the IMF).

131. Anna Maria Santacreu & Mackenzie Peake, *A Closer Look at China's Supposed Misappropriation of US Intellectual Property*, 5 ECON. SYNOPOSES 1 (2019).

In fact, even the United States has publicly acknowledged the improvement in Chinese IP enforcement in recent years.¹³² One notable example is the increased sanction, particularly the more frequent application of criminal sanction to IP infringements. In 2000, only forty-five cases that were registered with the Chinese State Administration of Industry and Commerce were subsequently referred to the Public Security Bureau for prosecution.¹³³ In 2016 alone, there were 8,352 first-instance criminal cases, involving 10,431 persons.¹³⁴ Another significant improvement is increased transparency. In 2014, the Chinese Supreme Court launched China Judgements Online, which made it possible for the public to search for Chinese judgments online.¹³⁵ One source indicates that a Beijing IP court published ninety-five percent of its cases.¹³⁶ In addition, China established specialized IP courts in Beijing, Shanghai, and Guangzhou, and in 2018, created a specialized IP court within the Supreme Court.¹³⁷ Lawyers have observed that judges in these courts possess greater competence and expertise than those in other Chinese courts, and these IP courts have also engaged in notable experiments to improve their independence and efficiency.¹³⁸ China has also opened several internet courts, including the first internet court in Hangzhou in August 2017, one in Shenzhen, and one in Beijing.¹³⁹ Several studies have found that foreign companies fare well in Chinese trials and appear to be treated

132. *USTR 2018 Special 301 Report*, *supra* note 55, at 39. See generally DAN PRUD'HOMME & TAOLUE ZHANG, CHINA'S INTELLECTUAL PROPERTY REGIME FOR INNOVATION: RISKS TO BUSINESS AND NATIONAL DEVELOPMENT (2019) (finding that China's IP regime for innovation has achieved significant improvement over time, but reforms are needed to address many aspects of its IP enforcement).

133. Bryan Mercurio, *The Protection and Enforcement of Intellectual Property in China Since Accession to the WTO: Progress and Retreat*, 1 CHINA PERSPECTIVE 27 (2012).

134. *Hearing on U.S. Tools to Address Chinese Market Distortions Before the U.S. China-Economic and Security Review Comm.*, 115th Cong. (June 8, 2018) [hereinafter Cohen] (statement of Mark Cohen, head of the Asia IP Project, Univ. of Cal. at Berkeley; former Senior Counsel, U.S. Patent and Trademark Office).

135. Susan Finder, *China's Evolving Case Law System in Practice*, 9 TSINGHUA CHINA L. REV. 245, 258 (2017).

136. Cohen, *supra* note 134.

137. *USTR 2018 Special 301 Report*, *supra* note 55, at 39.

138. Cohen, *supra* note 134 (Cohen's observation that the Beijing IP court has conducted reforms such as "citation to cases and use of case law; drafting of shorter and more to-the-point judicial opinions; the introduction of dissenting opinions and en banc decisions by judges; experimentation with amicus briefs; and diminished role of behind-the-scenes adjudication committees," many of which have long been sought after by US bar and businesses).

139. *USTR 2018 Special 301 Report*, *supra* note 55, at 39.

equally.¹⁴⁰ In March 2018, the Chinese government conducted a significant overhaul of its government structure.¹⁴¹ Several IP-related government functions were consolidated with an aim to enhance IP protection and enforcement in China.¹⁴² There is an overwhelming consensus in the IP legal community that China's IPR legal regime is now largely consistent with international norms.¹⁴³

B. *The Unverifiable Legal Deficiency*

While China was willing to make substantial concessions during the Sino-U.S. IPR negotiations in the 1990s and ratified them in subsequent legal amendments, the actual enforcement pattern has remained largely intact.¹⁴⁴ In fact, slack administrative enforcement continues to be a vexing issue that besets foreign investors in China.¹⁴⁵ But such a deficiency is largely unverifiable. Upon its accession to the WTO, China explicitly committed not to condition market access based on technology transfers.¹⁴⁶ China further committed to afford the same level of protection of IPRs to foreign firms as it did to its domestic companies under the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) Agreement.¹⁴⁷ However, since China's accession to the WTO, U.S. businesses have noted that many of the previous practices and policies with regard to forced technology transfer have

140. See, e.g., Brian Love, Christian Helmers & Markus Eberhardt, *Patent Litigation in China: Protecting Rights of the Local Economy*, 18 VAND. J. ENT. & TECH. L. 713 (2016); Rejun Bian, *Patent Litigation in China: Challenging Conventional Wisdom*, 33 BERKLEY TECH. L.J. 413 (2018); Chengguo Zhang & Jin Cao, *How Fair Is Patent Litigation in China? Evidence from the Beijing Courts*, 240 CHINA Q. 1, 4 (2019) (finding that being a foreign plaintiff has a positive and significant impact on win rates from a sample of 318 cases from 2004 to 2011 decided by Beijing First Intermediate People's Court).

141. *USTR 2018 Special 301 Report*, *supra* note 55, at 40.

142. *Id.* at 39.

143. *Id.*

144. MERTHA, *supra* note 122, at 8.

145. See Massey, *supra* note 121, at 236.

146. See *Protocol on the Accession of the People's Republic of China*, ¶ 7.3, WTO Doc. WT/L/432 (November 23, 2001); see also *Report of the Working Party on the Accession of China*, ¶ 203, WTO Doc. WT/ACC/CHN/49 (October 1, 2001) ("... would not be conditional upon performance requirements set by national or sub-national authorities, or subject to secondary conditions covering, for example, the conduct of research, the provision of offsets or other forms of industrial compensation including specified types or volumes of business opportunities, the use of local inputs, or the transfer of technology.").

147. Lee G. Branstetter, *China's Forced Technology Transfer Problem—and What to Do About It*, PETERSON INST. INT'L ECON., (June 2018), <https://www.piie.com/publications/policy-briefs/chinas-forced-technology-transfer-problem-and-what-do-about-it>.

become “implicit” and are carried out “behind closed doors.”¹⁴⁸ The opacity in China’s regulatory system has made it extremely difficult for the U.S. government to monitor and verify China’s compliance.¹⁴⁹

According to the complaints by U.S. companies and associations, there are a wide range of informal channels through which the Chinese government is able to pressure foreign firms to transfer its technology.¹⁵⁰ One common means is through the relatively opaque administrative approval process.¹⁵¹ It has been observed that Chinese officials have avoided explicit requirements in writing, and instead resorted to oral instructions or informal “administrative guidance” to exert pressures on foreign firms to transfer such technology.¹⁵² As the Chinese government (often through its state-owned firms) is a key player in many industry sectors, it can leverage its market power in purchasing and sales to pressure foreign firms to transfer technology without any formal directives.¹⁵³ For example, a foreign investor in a pharmaceutical joint venture (JV) was told that the Chinese government would only purchase its products if they were manufactured in China.¹⁵⁴ Because the Chinese government is one of its major clients, the foreign investor had no choice but to transfer technology to the JV in which it was only a minority shareholder.¹⁵⁵ Some have speculated that Chinese airlines preferred to purchase from Airbus rather than from Boeing because the latter had been unwilling to shift production to China.¹⁵⁶ They have suggested that Chinese authorities slowed down the regulatory approval for Airbus in order to pressure it to produce

148. USTR, *supra* note 9, at 19–20.

149. *Id.*

150. *Id.* at 20.

151. *Id.*; see also Covington & Burling, *Measures and Practices Restraining Foreign Investment in China*, IBERCHINA.ORG (Aug. 2014), http://www.iberchina.org/files/2017/restrictions_investment_china.pdf (prepared for the European Commission Directorate-General for Trade 11); Chamber of Commerce of the United States of America, *China’s Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* 2, 35, 40 (Nov. 11, 2012), https://www.uschamber.com/sites/default/files/documents/files/020021_China_InboundInvestment_Cvr.pdf.

152. USTR, *supra* note 9, at 20 (quoting ITIF, *Submission, Section 301 Hearing* 5–6 (Oct. 25, 2017)); see also Atkinson, Cory & Ezell, *supra* note 9, at 37.

153. USTR, *supra* note 9, at 33; see also *Testimony Before the U.S.-China Economic and Security Review Comm. Hearing on U.S. Companies in China*, 116th Cong. 8 (Feb. 28, 2019) [hereinafter *Wu Testimony*] (testimony of Prof. Mark Wu).

154. See Chamber of Commerce of the United States of America, *supra* note 151, at 40.

155. *Id.*

156. *Id.*; see also USTR, *supra* note 9, at 33.

more in China.¹⁵⁷ Indeed, China's unique state-led economy, with the state commanding a dominant position in a number of strategic sectors, provides the government with various channels to carry out its industrial policy agenda without any formal directive.¹⁵⁸ U.S. businesses have also found that in many cases, it was their business partners, rather than the Chinese government, that put such pressures on them to transfer technology.¹⁵⁹ Given the informality of such practices, it is very difficult for the United States to gather sufficient evidence to challenge China's practice.¹⁶⁰ What exacerbates the situation is that, very often, foreign companies themselves are reluctant to report such practices to the U.S. government for fear of retaliation from the Chinese government, which has various means to penalize a firm that it deems ill-behaved.¹⁶¹

The above U.S. findings, however, are mostly based on anecdotal evidence. The only systematic evidence thus far is based on survey evidence. The most recent survey conducted by the U.S.-China Business Council in 2017 reveals that nineteen percent of the respondents had been subject to forced technology transfer.¹⁶² Among them, thirty-three percent indicated that the request had come from a central government entity and twenty-five percent from a local government.¹⁶³ A further survey quoted by the Section 301 report was a 2017 survey of the U.S. integrated circuit design and manufacturing industry, in which twenty-five U.S. integrated circuit companies noted that they would

157. *Boeing to Open Its First 737 Plant in China Under Shadow of a Trade War*, BLOOMBERG (Dec. 13, 2018), <https://www.bloomberqint.com/business/boeing-s-first-china-737-plant-to-open-in-shadow-of-trade-war>.

158. *Wu Testimony*, *supra* note 153, at 8–9; *see also* Mark Wu, *The “China, Inc.” Challenge to Global Trade Governance*, 57 HARV. INT’L L.J. 261, 284 (2016) [hereinafter *Wu, The “China, Inc.”*]; Li-Wen Lin & Curtis J. Milhaupt, *We Are the (National) Champions*, 65 STAN. L. REV. 697 (2013).

159. *Wu Testimony*, *supra* note 153 (quoting USCBC, 2017 Member Survey 9 (2017)).

160. *Id.* at 21; *see also* Atkinson, Cory & Ezell, *supra* note 9, at 18.

161. *USTR*, *supra* note 9, at 9; *see also* Chamber of Commerce of the United States of America, *supra* note 151, at 40.

162. U.S.-CHINA BUSINESS COUNCIL, 2017 MEMBER SURVEY 9 (2017).

163. *Id.* (noting that more than 67 percent stated that the request was made directly by the Chinese partner rather than the Chinese government). The annual survey conducted by the American Chamber of Commerce in China suggests similar findings. In a 2013 survey of 325 companies in various sectors, more than a third of the respondents reported that they were concerned about “de facto” technology transfer as a condition for market access. Such a concern becomes more acute for those in advanced technology sectors, in which 42 percent of the respondents expressed such a concern. Only 3 percent of the respondents reported a decrease of such technology transfer, whereas 37 percent indicated that it was in fact increasing and 26 percent indicated that the status quo had remained. *USTR*, *supra* note 9, at 22 (quoting American Chamber of Commerce in China, *China Business Climate Survey Report* (2013)).

have to form JVs with Chinese companies to transfer intellectual property in order to obtain access to the Chinese market.¹⁶⁴ China, on the other hand, adamantly denies its practice of forced technology transfer. During the course of investigation, the Chinese trade associations and the law firms representing Chinese interests vehemently dismissed such allegations, claiming that the technology transfer was the product of voluntary exchanges rather than coerced government interventions.¹⁶⁵ As the Chinese spokesperson stated: “There is no forced technology transfer in China . . . the United States failed to provide a single piece of evidence, some of these claims were pure speculation.”¹⁶⁶

C. *The Government’s Residual Control*

As the above analysis demonstrates, most of the complaints from U. S. businesses relate to administrative enforcement. Thus, a successful implementation of the trade agreement hinges on the improvement in administrative enforcement. Yet as Andrew Mertha succinctly pointed out, economic pressures from the United States, even if they result in changes in official laws and regulations, must still “pass through China’s byzantine network of bureaucracies” before they are “translated into actual policy outcome.”¹⁶⁷ Meanwhile, administrative enforcement of IPRs is highly decentralized and fragmented in China. While politics are centralized in Beijing, the economic power of governance and legal enforcement have been delegated to the local governments.¹⁶⁸ Thus, even if the national government is willing to commit to the trade deal, significant uncertainties remain when the law is implemented at the local level. The chasm that divides policymaking and actual enforcement explains the repeated failed attempts by the United States to use economic sanction to pressure China to enforce against piracy in the 1990s.¹⁶⁹

In the late 1980s and early 1990s, China was placed on the “priority watch” list of countries under the Special 301 provision.¹⁷⁰ U.S. businesses voiced fierce complaints to Washington, alleging that the lack of

164. USTR, *supra* note 9, at 22 (quoting U.S. Department of Commerce, Bureau of Industry and Security, Assessment of the U.S. Integrated Circuit Design and Manufacturing Industry (forthcoming)).

165. USTR, *supra* note 9, at 21.

166. Tom Miles, *U.S. and China Clash over “Technology Transfer” at the WTO*, REUTERS, May 28, 2018.

167. MERTHA, *supra* note 122, at 6.

168. *See generally* SUSAN L. SHIRK, *THE POLITICAL LOGIC OF ECONOMIC REFORM IN CHINA* (1993).

169. MERTHA, *supra* note 122, at 5.

170. MICHAEL P. RYAN, *KNOWLEDGE DIPLOMACY: GLOBAL COMPETITION AND THE POLITICS OF INTELLECTUAL PROPERTY* 80 (1998) (explaining that the “[p]riority watch” list includes countries

copyright protection in China had cost them \$400 million in lost revenue each year.¹⁷¹ The USTR threatened to impose tariffs on \$1.5 billion of a wide range of Chinese imports in 1992.¹⁷² Given the economic pressures from the United States, China agreed to the “Sino-American Memorandum of Understanding on the Protection of Intellectual Property” in 1992.¹⁷³ Being the most formal among IPRs-related agreements signed by the two countries in the 1990s, the 1992 agreement specifies a number of legislative commitments by China.¹⁷⁴ It contains seven articles, touching on issues concerning patent protection, copyright law protection, trade secrets, enforcement, and consultation.¹⁷⁵ China largely satisfied the U.S. demands, and afforded foreign IPRs the protection level as mandated in the MOU.¹⁷⁶

The 1992 MOU focuses on legislation rather than enforcement. By 1994, Chinese IP infringements were estimated to amount to \$1 billion and were expected to rise rapidly.¹⁷⁷ China’s lackluster enforcement of its IP law then prompted another round of intensive Sino-U.S. negotiations in 1994 and 1995.¹⁷⁸ To assuage business criticism, in 1994, the Clinton administration renewed a Section 301 investigation into China’s IP practices.¹⁷⁹ The USTR threatened China again with economic sanctions and attempted to impose higher tariffs on \$2.8 billion Chinese imports, and China retaliated.¹⁸⁰ The two sides eventually reached an agreement on February 26, 1995.¹⁸¹

In a letter from the then Chinese premier Wu Yi to USTR Kantor (Exchange of Letters), the Chinese government promised significant restructuring of the enforcement structure to increase enforcement at the manufacturing and retail levels.¹⁸² An enforcement-based “Action

that have onerous or egregious IP policies or practices but are not yet the target of deadlined negotiations).

171. *Id.* at 57–66.

172. *Id.*

173. Andrew Mertha & Robert Pahre, *Patently Misleading: Partial Implementation and Bargaining Leverage in Sino-American Negotiations on Intellectual Property Rights*, 59 INT’L ORG. 695, 701 (2005).

174. *See id.*

175. MERTHA, *supra* note 122, at 45–46.

176. Mertha & Pahre, *supra* note 173, at 701.

177. RYAN, *supra* note 170, at 81.

178. Mertha & Pahre, *supra* note 173, at 702.

179. RYAN, *supra* note 170, at 81–82.

180. *Id.* at 83.

181. 1995 Agreement, *supra* note 123.

182. Mertha & Pahre, *supra* note 173, at 702 (explaining that the Chinese government promised to enforce the Action Plan attached to Wu Yi’s letter and to impose criminal sanctions for IPR violations, to enhance enforcement at the manufacturing and retail stages and allow

Plan” was also attached to the agreement, specifying the detailed enforcement structure and the concrete steps to disseminate information, provide training, as well as improve the environment for enforcing the IP law.¹⁸³ Specifically, the Exchange of Letters mandated the establishment of task forces at all levels of the Chinese government that would include personnel from various administrative agencies in charge of IP protection.¹⁸⁴ The task forces would coordinate and organize enforcement activities among various government departments, monitor the implementation of the IPR laws and regulations, instruct and organize the relevant authorities to provide education and publicity for IPR-related laws, and ensure the consistency of legal sanctions for IPR infringements.¹⁸⁵ The task forces would also be authorized to conduct investigations and impose sanctions in case of infringements.¹⁸⁶ The Exchange of Letters also specified a “special enforcement period,” in which China had committed to use extensive resources to enhance the enforcement of IPR throughout China.¹⁸⁷ Some commentators were surprised that China was willing to make such extraordinary concessions to build national institutions to enforce the IP law, as it ran the risk of undermining national sovereignty.¹⁸⁸

Despite the far-reaching scope of the Exchange of Letters and the progress that the Chinese authorities had shown in enforcement during the negotiation of the agreement, enforcement did not make much headway.¹⁸⁹ The Exchange of Letters did not put a stop to the manufacturing and sales of IPR-violating goods, which grew almost immediately after the agreement was signed.¹⁹⁰ In May 1996, the USTR threatened

revenue-sharing arrangements with US manufacturers, and to continue bilateral training programs and other consultative exchanges).

183. *Id.*; see also MERTHA, *supra* note 122, at 50–51 (explaining that the first section of the Action Plan institutionalized the formation of China’s Intellectual Property Rights Working Conference at the national and subnational levels, as well as a series of IPR “task forces” to enhance the enforcement of intellectual property in China, that it also outlined a “special enforcement period,” in which extensive resources would be brought to bear on increasing the enforcement of IPR throughout China, and that the Action Plan also discussed extensively the concrete steps to enhance enforcement in copyright-related administrative enforcement).

184. 1995 Agreement, *supra* note 123; see also RYAN, *supra* note 170, at 83; MERTHA, *supra* note 122, at 102–04.

185. 1995 Agreement, *supra* note 123.

186. *Id.*

187. *Id.*; see also Mertha & Pahre, *supra* note 173, at 702.

188. MERTHA, *supra* note 122, at 51.

189. See Mertha & Pahre, *supra* note 173, at 704.

190. See *id.* at 702; see also KA ZENG, TRADE THREATS, TRADE WARS: BARGAINING, RETALIATION, AND AMERICAN COERCIVE DIPLOMACY 169 (2004) (“On the whole, it seems fair to say that the

to impose tariff sanction on \$3 billion of Chinese goods.¹⁹¹ Thus, less than a year after the Exchange of Letters, the United States and China found themselves back at the negotiation table again.¹⁹² The negotiation ultimately culminated in an agreement entitled "Report on Chinese enforcement actions under the 1995 IPR Agreement," signed in June 1996.¹⁹³ The 1996 agreement largely restated many provisions in the 1995 Exchange of Letters, a sign that the previous agreement was poorly executed.¹⁹⁴ During the winter of 1996 to 1997, the Chinese authorities worked with their U.S. counterparts to shut down three dozen manufacturers in Guangdong that produced illegal CDs, CD-ROMs, and disks.¹⁹⁵ The closure of these plants provided the Clinton administration with a tangible way to measure China's compliance with the agreement.¹⁹⁶ Thus, although China did not implement other provisions in the 1996 agreement, this partial implementation helped ease some of the United States' concerns about copyright infringements and kept the United States from escalating economic sanctions against China.¹⁹⁷

Many experts have attributed China's lackluster IP enforcement to its complex and intricate economic and political institutions, the multifaceted and layered levels of bureaucracy responsible for the enforcement of IP laws, a great degree of heterogeneity among different regions, and a significant conflict of interest among different departments and regional governments.¹⁹⁸ Indeed, the actual implementation of the trade agreement requires cooperation from the local administrative agencies, which are beholden to the local governments that control their budget and personnel appointments.¹⁹⁹ Moreover, the bureaucratic apparatus in charge of enforcing the IPR at the local level tends to "be convoluted and opaque."²⁰⁰ Typically, the central government instructs the local governments in the form of nonbinding notices, and thus the local governments have significant discretion in determining the level of effort that they will exert on

United States has by and large failed to achieve its objective of obtaining improved IPR protection for American industries.").

191. RYAN, *supra* note 170, at 84.

192. Mertha & Pahre, *supra* note 173, at 702.

193. 1996 Agreement, *supra* note 123.

194. Mertha & Pahre, *supra* note 173, at 702; *see also* MERTHA, *supra* note 122, at 52.

195. Mertha & Pahre, *supra* note 173, at 703.

196. *Id.*

197. *Id.*

198. Mercurio, *supra* note 133.

199. MERTHA, *supra* note 122, at 15.

200. *Id.*

implementation.²⁰¹ But even binding laws and regulations do not guarantee full implementation. Local officials still have broad discretion in determining the levels of fines and penalties in case of infringements, and thus could impose trivial fines without sufficient deterrence.²⁰² Some scholars have suggested that China was only willing to make such extraordinary concessions to the United States by signing a wide-ranging trade agreement in 1995 precisely because it knew that it would only partially implement the agreement.²⁰³ In fact, partial implementation helped the national leadership, particularly the core leader Jiang Zemin, appear stronger in the eyes of other constituents in the government and the CCP at that time.²⁰⁴ If Jiang had guaranteed the United States full implementation, the agreement would have been perceived as weak and lost its strength vis-à-vis the provinces.²⁰⁵ The U.S. negotiators, on the other hand, also anticipating partial implementation only, were realistic about China's compliance and only pressed on the core issues.²⁰⁶

Accordingly, even if the U.S. government is successful in pushing China to commit to a laundry list of changes to its national law, it will only alleviate the symptoms on the surface without resolving the problems at root. Much of the legal deficiency in Chinese IP enforcement as alleged by U.S. businesses is difficult to monitor and almost impossible to verify. Unless China fundamentally revamps its state-led economic structure, the government has significant leeway to obviate the formal legal requirements to achieve its policy goals. Indeed, many aspects of the law enforcement are not contractible, and the Chinese government retains residual control in enforcing its laws. The potential misalignment of interest between the central and the local governments in China presents further challenges to the successful implementation of the laws.

IV. THE ENFORCEABILITY OF THE AGREEMENT

The issue of enforceability is another contributing factor for the incompleteness of the trade agreement. By invoking a 301 investigation against China, the United States risks violating its WTO commitments, making it impossible for it to directly enforce the trade agreement in a

201. Mertha & Pahre, *supra* note 173, at 716.

202. *Id.*

203. *Id.* at 719.

204. *Id.* at 700–01.

205. *Id.* at 701.

206. *Id.* at 718.

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WTO court. It is also extremely difficult for the United States to win a case against China for inadequate IP protection at the WTO. As such, the trade agreement is largely above the law. Meanwhile, the trade agreement will not be self-enforcing. The complementarity of the U.S. and Chinese trade structures and the integration of the global supply chain act as strong counteracting forces against trade sanctions on China. Tariff sanction is a costly punishment device and the United States cannot simply inflict harm on China without also injuring itself. Given its constantly changing political and economic interests, the United States' threat of imposing sustained tariff sanctions on China appears incredible. As the trade agreement is not enforceable, there are no effective means to ensure China's compliance. Therefore, the Sino-U.S. trade agreement is a weak legal instrument and will not be sustainable.

A. *The Agreement Is Above the Law*

One of the distinctive features of the trade agreement that the United States is negotiating with China is that it cannot be enforced by a third party. The Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), part of the WTO rules, explicitly prohibits unilateral determination or retaliation against another WTO member for WTO violations.²⁰⁷ The TRIPs Agreement also explicitly mandates that disputes arising under the Agreement are required to be settled through the mandatory dispute resolution process of the WTO.²⁰⁸ A WTO panel ruling in 1999 noted that unilateral actions under Section 301 are inconsistent with WTO obligations except under limited circumstances.²⁰⁹ Since the inception of the WTO, the United States has rarely invoked a Section 301 investigation against another WTO member.²¹⁰ In a dramatic departure from its previous practice, the Trump administration resorted to self-help by unilaterally

207. The Understanding on Rules and Procedures Governing the Settlement of Disputes art. 23, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, 1869 U.N.T.S. 401.

208. Agreement on Trade-Related Aspects of Intellectual Property Rights art. 64, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, 108 Stat. 4809, 1869 U.N.T.S. 299 [hereinafter TRIPS Agreement] (prohibiting a member state from taking counteractive measures against another member state before it has exhausted all alternative actions as permissible under the rules); see also Yu, *supra* note 125, at 924.

209. See Panel Report, *United States—Sections 301–310 of the Trade Act of 1974*, ¶¶ 7.71–7.92, WTO Doc. WT/DS152/R (Dec. 22, 1999); see also Brewster, *supra* note 1, at 256–59.

210. MORRISON, *supra* note 37 (noting that since the United States joined the WTO in 1995, the “USTR still sometimes brought Section 301 investigations but then brought the issues at hand

launching a Section 301 investigation into China's IP and innovation policy in 2018.²¹¹ Such a move risked violating the WTO rules and threatened to undermine the global trading system.²¹² Since April 2018, China has filed three requests for consultation at the WTO on the impending tariff sanction that the U.S. government has threatened to impose on certain Chinese goods.²¹³

As an alternative to directly enforcing the trade agreement in the WTO, the United States can also separately challenge China's inadequate IPR protection through the WTO. However, the ambiguity of the WTO rules, the difficulty to amass evidence, as well as the structural barriers to challenging China's inadequate IP enforcement at the WTO have all posed challenges for the United States in winning such cases.²¹⁴ As illustrated in the preceding Part (III) (B), because many of China's requirements for technology transfer are implicit rather than explicit, it is almost impossible for a third party like the WTO to verify the U.S.

to the WTO for dispute resolution. After 2010 [and before 2018], the USTR brought all trade disputes involving WTO members directly to the WTO for adjudication.”).

211. *USTR 2018 Report*, *supra* note 46, at 6.

212. See Rachel Brewster, *The Trump Administration and the Future of the WTO*, 44 YALE J. INT'L L. ONLINE 6, 9 (2019); see also Robert Z. Lawrence, *How the United States Should Confront China Without Threatening the Global Trading System*, PETERSON INST. FOR INT'L ECON. (2018). On the other hand, the United States can strategically claim that its current dispute with China falls outside of WTO. Such framing can serve two purposes: first, it helps the United States achieve more negotiation freedom without having to involve the WTO; second, it helps preserve the integrity of the WTO without infringing its rules for multilateral resolution of disputes. See Rachel Brewster, *Analyzing the Trump Administration's International Trade Strategy*, 42 FORDHAM INT'L L.J. 1419, 1424–25 (2019).

213. Request for Consultations by China, *United States - Tariff Measures on Certain Goods from China*, WTO Doc. WT/DS543/1 (Apr. 5, 2018); Request for Consultations by China, *United States-Tariff Measures on Certain Goods from China II*, WTO Doc. WT/DS565/1 (Aug. 27, 2018); Request for Consultations by China, *United States-Tariff Measures on Certain Goods from China III*, WTO Doc. WT/DS587/1 (Sept. 4, 2019) (claiming that the impending tariff would violate the most-favored-nation treatment obligation under GATT 1994 and the US Schedule of Concessions and Commitments and that the United States' unilateral action had violated article 23 of the Understanding on Rules and Procedures Governing the Settlement of Disputes).

214. Yu, *supra* note 125, at 923. Some experts have suggested that the United States consider bringing the “non-violation, nullification and impairment” case to handle those Chinese cases that are not explicitly deemed illegal. However, others have noted that such an innovative approach may be very challenging to implement in practice given the difficulty of satisfying the evidentiary burden in a WTO proceeding, the coordination that it requires with allies, and the time-consuming nature of such litigation. See TRIPS Agreement, *supra* note 208, art. 64.2; see also “Non-Violation” Complaints (Article 64.2), WTO, https://www.wto.org/english/tratop_e/trips_e/nonviolation_e.htm (last visited Aug. 26, 2020); Wu *Testimony*, *supra* note 153; Ton Zuijdwijk, *Understanding the Intellectual Property Dispute between China and the United States*, CTR. FOR INT'L GOVERNANCE INNOVATION (May 15, 2019), <https://www.cigionline.org/articles/understanding-intellectual-property-disputes-between-china-and-united-states>.

allegations. As such, it is exceedingly hard for the United States to seek WTO remedies for combatting deficiencies in enforcement rather than in the black-letter law.²¹⁵ Indeed, many U.S. policymakers have long held suspicions against the WTO that it is too costly, too slow, and inefficient.²¹⁶ The U.S. chief negotiator Mr. Lighthizer has been one of the most outspoken critics.²¹⁷ In a testimony given to the USTR in 2010, Mr. Lighthizer expressed frustration with the WTO resolution mechanism, complaining about its inefficiency, its inability to deal with broad policy issues, and the uncertainty about China's compliance with its WTO obligations despite the United States' success at the WTO.²¹⁸ Indeed, the United States has brought twenty-three challenges at the WTO against China, but only two are IP-related cases and both were targeted at the legal provisions rather than the enforcement.²¹⁹

215. Branstetter, *supra* note 147; cf. *U.S. Tools to Address Chinese Market Distortions: Hearing before the US-China Econ. and Rev. Sec. Comm'n*, 115th Cong. (2018) [hereinafter *Testimony of Jennifer Hillman*] (testimony of Jennifer Hillman, Professor from Practice, Georgetown University Law Center) (advocating launching a big, bold WTO case against China).

216. U.S. policymakers have long held suspicions against the WTO. See Wu, *The "China, Inc., supra* note 158, at 266–67 (noting that many western commentators have been skeptical about the WTO and urged their governments to move beyond the WTO to deal with China); see also *Testimony of Lighthizer, supra* note 12, at 24; Phoenix X. Cai, *Think Big and Ignore the Law: U.S. Corn and Ethanol Subsidies and WTO Law*, 40 GEO. J. INT'L L. 865, 911 (2009).

217. Shawn Donnan, *Lighthizer Vows to Crack Down on Unfair China Practices*, FIN. TIMES (Mar. 14, 2017), <https://www.ft.com/content/5300b8f2-08f6-11e7-97d1-5e720a26771b> (quoting Mr. Lighthizer who stated that WTO is ill-equipped to deal with China's industrial policy and called for creative alternative approaches instead); Susan A. Aaronson, *Is China Killing the WTO?* INT'L ECON., Winter 2010, at 41, http://www.international-economy.com/TIE_W10_Aaronson.pdf; Stephen J. Ezell & Robert D. Atkinson, *False Promises: The Yawning Gap Between China's WTO Commitments and Practices*, INFO. TECH. & INNOVATION FOUND. (Sept. 2015), http://www2.itif.org/2015-false-promises-china.pdf?_ga=2.203454672.1335606600.1590254800-779049106.1590254800. But there were also scholars that objected to the unilateral approach. See *Testimony of Jennifer Hillman, supra* note 215.

218. See *Testimony of Lighthizer, supra* note 12, at 24.

219. In April 2007, the United States launched an action against China in the WTO, accusing it of inadequate criminal procedures and penalties for counterfeiting and piracy in China, improper disposal of infringing goods confiscated by customs authorities, and denial of copyright protection to works that have not been authorized for publication in China. The United States was only partially successful in its claims against certain Chinese customs and copyright provisions; its demand for increasing criminal sanctions and penalties was not supported by the WTO panel. See Panel Report, *China-Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WTO Doc. WT/DS362/R (Jan. 26, 2009). In March 2018, the United States initiated a WTO dispute against China, alleging that China's technology transfer regulations discriminated against foreign patent holders and prevented them from enforcing their patent rights or negotiating licensing contracts on market-based terms. As discussed in the preceding Part II, China abolished several of the measures targeted by the WTO case and adopted a new Foreign Investment Law that restricts forced technology transfer during the spring of 2019. In

Moreover, there is a limit to what the United States can achieve through the WTO litigation, as the WTO cases are only effective against a limited area of Chinese practices.²²⁰ The WTO rules were not written in anticipation of China's distinctive economic structure today, which is fundamentally different from that of other countries and is also very different from that of China at the time of its WTO accession.²²¹ Some in the United States believe that China has unabashedly employed its own economic system to exploit loopholes in the WTO.²²² In recent years, China has increasingly resorted to retaliatory trade remedies, deterring other WTO members from speaking against China.²²³ Thus, while the United States has become more circumspect about the WTO, China is actually seeking to empower the WTO Appellate Body.²²⁴ In addition, the Trump administration strategically blocked the appointment of new judges to the Appellate Body to prevent it from functioning.²²⁵ The various moves of the United States send a strong signal that it is shifting from a rule-oriented trade diplomacy to a power-oriented one.²²⁶ Accordingly, it seems highly unlikely that the Trump administration will return to the multilateral settlement mechanism to resolve its current dispute with China.²²⁷

light of these new legislative developments, the United States formally requested that the WTO panel suspend its proceedings in June 2019. *See* Communication from the Panel, *China-Certain Measures Concerning the Protection of Intellectual Property Rights*, WTO Doc. WT/DS542/10 (June 14, 2019).

220. *Wu Testimony*, *supra* note 153, at 12.

221. *See Wu*, *The "China, Inc."*, *supra* note 158, at 265–66 (explaining that China's rise and its distinctive economic structure have posed a systemic challenge to the WTO and that the Chinese economy has undergone significant transformations since its accession to the WTO).

222. *See* Atkinson, Cory & Ezell., *supra* note 9, at 23; *cf.* Wentong Zheng, *Trade Law's Responses to the Rise of China*, 34 BERKELEY J. INT'L L. 109, 109 (2016) (arguing that the trade law is rather successful in accommodating China in the new world trade order).

223. Mark Wu, *Antidumping in Asia's Emerging Giants*, 53 HARV. INT'L L.J. 1, 2 (2012) (noting China's aggressive use of antidumping law against their trading partners).

224. *USTR 2018 Report*, *supra* note 46, at 23.

225. Gregory Shaffer, *A Tragedy in the Making? The Decline of Law and the Return of Power in International Trade Relations*, 44 YALE J. INT'L L. ONLINE 37, 40–41 (2018).

226. *See generally* John H. Jackson, *The Crumbling Institutions of the Liberal Trade System*, 12 J. WORLD TRADE L. 93 (1978) (proposing that there are two types of peaceful settlement of international disputes: settlement by negotiation with reference to relative power of the countries, the so-called power-oriented diplomacy, and settlement with reference to the agreed rules and norms, the rule-oriented trade diplomacy).

227. Shaffer, *supra* note 225, at 52 (noting that "[t]he Trump Administration will unlikely agree to binding panel or arbitral decisions in disputes that it considers sensitive, particularly disputes brought by China").

B. *The Agreement Is Not Self-Enforcing*

While the Sino-U.S. trade agreement is unenforceable by a formal legal institution, it could still work if the parties choose to rely on self-enforcement. A self-enforcing agreement between two parties remains in force as long as the parties believe that they are better off keeping the agreement than terminating it.²²⁸ As no third party will enforce the agreement, it is up to the two parties to determine whether there are any violations.²²⁹ Accordingly, a self-enforcing agreement is possible only if the expected gains from adherence to the agreement exceed the gains from violating the agreement.²³⁰ The threat of punishment from violation must be renegotiation-proof.²³¹ Self-enforcing contracts are common, as Stuart Macaulay has long documented in his empirical investigation of business dealings.²³² Reputation and the repeated interactions among the parties have been shown to be effective in enforcing contractual arrangements in the absence of formal enforcement.²³³

For the Sino-U.S. agreement to be self-enforcing, the U.S. punishment under the trade agreement must be a credible one to deter China from deviating from its commitments. Such credibility hinges upon the costs and risks for the United States in administering such punishment.²³⁴ But it is highly costly and risky for the United States to impose sustained trade sanctions on China. To begin with, the United States and China are each other's most important trading partner.²³⁵ The economic and trade complementarities between them undermine U.S.

228. L.G. Telser, *A Theory of Self-Enforcing Agreement*, 53 J. BUS. 27, 27 (1980); see generally Benjamin Klein, *Why Hold-Ups Occur: The Self-Enforcing Range of Contractual Relationships*, 34 ECON. INQUIRY 444 (1996); see Robert E. Scott, *Conflict and Cooperation in Long-Term Contracts*, 75 CAL. L. REV. 2005, 2039–50 (1987).

229. Telser, *supra* note 228, at 27, 29.

230. *Id.* at 29.

231. Self-enforcing agreements are quite common in sovereign debts. See Kenneth M. Kletzer & Brian D. Wright, *Sovereign Debt as Intertemporal Barter*, 90 AM. ECON. REV. 621, 622 (2000); see also generally Ugo Panizza, Federico Sturzenegger & Jeromin Zettelmeyer, *The Economics and Law of Sovereign Debt and Default*, 47 J. ECON. LITERATURE 651 (2009).

232. Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963).

233. See, e.g., Avner Grief, *Contract Enforceability and Economic Institutions in Early Trade: The Maghribi Traders' Coalition*, 83 AM. ECON. REV. 525, 526 (1993); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992).

234. SCHELLING, *supra* note 26, at 6.

235. LAWRENCE J. LAU, *THE CHINA-US TRADE WAR AND FUTURE ECONOMIC RELATIONS* 117–18 (2018).

credibility to impose sustained tariff sanctions on China.²³⁶ The United States is endowed with rich arable land, readily usable water, and other natural resources while China is not.²³⁷ China's comparative advantage lies in its large surplus of labor which the United States lacks.²³⁸ The two countries are also at different stages of development—the United States has been a mature and developed economy for over a century while China is still a developing country in terms of real GDP per capita.²³⁹ The United States is far ahead of China in science and technology capabilities, and China will continue to rely on significant technological support from the United States.²⁴⁰ These differences between the two countries enable them to derive large gains from trading with each other.²⁴¹ The Sino-U.S. trade complementarities therefore imply a low elasticity of demand for each other's products and high costs in case of a disruption in trade.²⁴²

In the 1990s, when the U.S. government threatened economic sanctions on Chinese imports, it faced stiff opposition from many domestic interest groups.²⁴³ Although companies in copyright industries, which were adversely affected by Chinese piracy, were calling for sanctions against China, many other retailers and manufacturers that had developed a high degree of reliance on the Chinese imports strongly opposed closing the American market to the Chinese manufacturers.²⁴⁴ These U.S. importers, retailers, and manufacturers voiced fierce complaints to Washington that punitive tariffs would force many retailers to raise prices, as they could not source the goods from elsewhere or at a similar price.²⁴⁵ This strong opposition from businesses weakened the position of the USTR and prevented it from further escalating the dispute.²⁴⁶ In contrast, the U.S. sanction on Japanese electronic products in the mid-1980s won solid endorsement from the U.S. business

236. ZENG, *supra* note 190, at 238 (stating that a trade relationship is considered complementary when two countries engage in the export of different sets of commodities wherein they each have their own comparative advantages, and they trade them for cheaper imports); see generally JOHN A.C. CONYBEARE, *TRADE WARS: THE THEORY AND PRACTICE OF INTERNATIONAL COMMERCIAL RIVALRY* (1987).

237. LAU, *supra* note 235, at 106.

238. *Id.*

239. *Id.* at 154.

240. *Id.* at 107.

241. *Id.* at 154.

242. CONYBEARE, *supra* note 236, at 47.

243. ZENG, *supra* note 190, at 16.

244. *Id.* at 170.

245. *Id.* at 172.

246. *Id.* at 171.

community.²⁴⁷ Due to the competitive trade structure between the United States and Japan, the trade sanction on Japanese imports enjoyed support from both export-seeking domestic manufacturers who were seeking to expand access to the Japanese market, as well as domestic industries who were facing stiff competition from Japanese imports.²⁴⁸

The current business reaction to the Trump administration's tariff threat on China is a case of *déjà vu*. According to the survey by the American Chamber of commerce, nearly sixty-nine percent of the 434 respondents to the annual China Business Climate Survey opposed the tariffs, while only 8.5 percent backed them.²⁴⁹ In June 2019, 320 representatives from U.S. manufacturers, retailers, and other companies and trade groups flocked to Washington to appear in a seven-day hearing on Trump's proposed tariffs on China.²⁵⁰ Most of these companies opposed the tariff, noting that the importers would bear most of the costs while some would be passed down to consumers who would pay higher prices.²⁵¹ In a letter to Trump in June 2019, 600 retailers, including Walmart and Target, urged the president to return to the negotiation table with China, noting that the tariffs had hurt American businesses and consumers rather than China.²⁵² Indeed, as the negotiation unfolded, the Trump administration came under strong pressure from a large segment of the business community to soften its position against China.²⁵³ The U.S. Chamber of Commerce, the American Chamber of Commerce in China, as well as the political network for Koch industries, one of the largest and most influential Republican donors, have all denounced Trump's unilateral sanction on China and

247. *Id.* at 16.

248. *Id.*

249. John Ruwith, *U.S. Companies in China Mostly Oppose Tariffs, Survey Shows*, REUTERS BUS. NEWS (July 11, 2018), <https://www.reuters.com/article/us-usa-trade-china-survey/u-s-companies-in-china-mostly-oppose-tariffs-survey-shows-idUSKBN1K20A3>.

250. *To Fight Donald Trump's China Tariffs, Hundreds of US Companies Descend on Washington*, BLOOMBERG (June 18, 2019), <https://www.scmp.com/news/china/article/3014934/fight-donald-trumps-china-tariffs-hundreds-us-companies-descend>.

251. *Id.*

252. Nandita Bose, *Over 600 U.S. Companies Urge Trump to Resolve Trade Dispute with China: Letter*, REUTERS BUS. NEWS (June 14, 2019), <https://www.reuters.com/article/us-usa-trade-china-tariffs/over-600-u-s-companies-urge-trump-to-resolve-trade-dispute-with-china-letter-idUSKCN1TE36K>.

253. Alan W. Cafruny, *Global Trade War? Contradictions of US Trade Policy in the Trump Era*, No. 93 VALDAI DISCUSSION CLUB 3, 10 (Sept. 17, 2018), <https://valdaiclub.com/files/19310/> or <https://valdaiclub.com/a/valdai-papers/valdai-paper-93-glodal-trade-war-contradictions/>.

launched aggressive campaigns against tariffs.²⁵⁴ Congress has also begun to propose bipartisan legislation to curtail the president's authority to impose tariffs.²⁵⁵ Even within the Trump administration, there is a division between the globalists, as represented by Secretary of the Treasury Steven Mnuchin, who seek to restraint tariff sanction and to limit demands on China, and the nationalists, as represented by USTR Robert Lighthizer and White House trade advisor Peter Navarro, who believe multilateral institutions are inadequate in dealing with problems with China and who advocate for tariff sanctions instead.²⁵⁶

The global supply chain imposes another constraint on tariff sanctions. In today's global economy, many products are no longer exclusively produced in one country.²⁵⁷ A typical product, even one labelled as "made in China," could be assembled in China but sourced from many other countries, including the United States. For instance, Chinese national champions such as ZTE and Huawei rely heavily on U.S. manufacturers for a significant percentage of their individual parts.²⁵⁸ In fact, a quarter of Huawei's products are supplied by leading American technology companies such as Qualcomm, Intel, Broadcom, and Flex, and these American suppliers derive over \$1 billion annual revenue from sales to Huawei.²⁵⁹ As the second largest smartphone maker in the world, Huawei also relies on Google for its Android

254. See Chamber of Commerce of the United States of America, Trade Works. Tariffs Don't, <https://www.uschamber.com/tariffs> (last visited Aug 26, 2020); Chamber of Commerce of the United States of America and American Chamber of Commerce in China, Priority Recommendations for U.S.-China Trade Negotiations from the U.S. Chamber of Commerce and American Chamber of Commerce in China (Jan. 16, 2019), <https://www.wsj.com/public/resources/documents/tradereport.pdf>; Brian Schwartz, *Billionaire Koch Brothers' Political Network Will Spend Millions to Oppose Trump's Tariffs—The Group's Biggest Split with the President So Far*, CNBC (June 4, 2018), <https://www.cnbc.com/2018/06/04/koch-network-plans-to-spend-millions-to-fight-trumps-tariffs.html>.

255. Lindsay Wise, *Lawmakers Make Long-Shot Bid to Check Presidential Tariff Powers*, WALL STREET J. (Sept. 15, 2019), <https://www.wsj.com/articles/lawmakers-make-long-shot-bid-to-check-presidential-tariff-powers-11568571897> (noting that US senators are proposing a bill to curtail presidential power to impose tariffs on foreign countries).

256. Cafruny, *supra* note 253, at 10–11 (noting that Trump needs to mediate between the nationalists and the globalists within his administration).

257. Barbara Jorgensen, *Would A Huawei Boycott Unravel the Supply Chain*, EPS NEWS (Feb. 27, 2019), <https://epsnews.com/2019/02/27/huawei-boycott-supply-chain/>.

258. Geoffrey Garrett, *Why U.S.-China Supply Chains Are Stronger Than the Trade War*, KNOWLEDGE@WHARTON (Sept. 5, 2019), <https://knowledge.wharton.upenn.edu/article/trade-war-supply-chain-impact/>.

259. *Id.*; see also Emily Feng, *U.S. Move to Isolate Huawei Sends Ripples Through Global Supply Chain*, NPR, (May 16, 2019), <https://www.npr.org/2019/05/16/723983055/u-s-move-to-isolate-huawei-sends-ripples-through-global-supply-chain>.

operating system.²⁶⁰ Meanwhile, successful U.S. companies such as Nike and Apple relies heavily on the Chinese manufacturers for assembling or manufacturing their components.²⁶¹ As acknowledged by Tim Cook, Apple's CEO, China is integral to Apple's success not because of its price but quality—it is exceedingly hard for Apple to find an alternative to Chinese labor and skills in any other country.²⁶² For these reasons, Geoffrey Garrett is optimistic about the Sino-U.S. trade relationship: "America and China are co-dependent on each other with supply chain interconnections amounting to a dense thicket of ties binding the two countries together."²⁶³

Above all, the trade sanction is not renegotiation-proof, as illustrated by the Sino-U.S. IPR negotiations in the 1990s. When China was found to be in violation of the trade agreement, the two sides would find themselves back at the renegotiation table and then would accept a new agreement.²⁶⁴ After all, the political and economic interests of the United States are always changing.²⁶⁵ In a bargaining game, the player who is more patient will have an important advantage over the other player.²⁶⁶ The U.S. political system is notoriously impatient, with the media, interest groups, and political parties constantly putting pressures on the administration to deliver quick results.²⁶⁷ Shang-Jin Wei pointed out the United States has been more willing to cooperate with China to try to spur a global recovery during its downturn.²⁶⁸ A

260. Garrett, *supra* note 258.

261. *Id.*

262. *Id.* (quoting remark by Tim Cook that "[t]he products we do require really advanced tooling, and the precision that you have to have, the tooling and working with the materials that we do are state of the art. And the tooling skill is very deep here. In the U.S. you could have a meeting of tooling engineers and I'm not sure we could fill the room. In China you could fill multiple football fields.").

263. *Id.*

264. Mertha & Pahre, *supra* note 173, at 701–02.

265. Morrow, *supra* note 100, at 92 ("Commitment is a problem when actors' incentives change over time.").

266. DIXIT, SKEATH & REILEY, *supra* note 99, at 683.

267. *Id.*; see also Quinn Slobodian, *You Live in Robert Lighthizer's World Now*, FOREIGN POL'Y (Aug. 6, 2018), <https://foreignpolicy.com/2018/08/06/you-live-in-robert-lighthizers-world-now-trump-trade/> (quoting acknowledgement by Robert Lighthizer during his testimony: "[the Chinese] do take a longer view, which by the way, I think it is the right view. To the extent we can, we ought to be taking it. I realize we have a political system that makes it difficult, but nonetheless, the reality is an awful lot of our senior politicians do take a long view.").

268. Shang-Jin Wei, *Could A U.S. Recession End the Trade War?*, PROJECT SYNDICATE (Aug. 28, 2019), <https://www.project-syndicate.org/commentary/america-recession-could-end-china-trade-war-by-shang-jin-wei-2019-08>.

prominent example is the last U.S. recession in 2008-2010, when the Sino-U.S. ties improved partly due to China's status as the only major economy that was able and willing to boost the global demand.²⁶⁹ Wei therefore predicted that Trump's stance toward China may soften if a recession materializes.²⁷⁰ Zhiwu Chen also predicted that Trump will be under more pressures to strike a deal with China to help his re-election bid after October 2019.²⁷¹ As much of the damage to China's supply chain has already been done, Chen believes that China is in no hurry to reach a trade agreement.²⁷²

Consider the following scenario: The United States and China come to a trade agreement, but it turns out that China has violated its obligations. The United States then decides to punish China with a tariff sanction. However, the sanction also harms the interest of many U.S. consumers and firms that depend on imports from China. They lobby the U.S. administration against adopting overly punitive measures against China. Meanwhile, China retaliates by curbing the operation of U.S. businesses in China, reducing its holding of U.S. treasury bonds, and curtailing rare earth supply to the United States. The Chinese economy suffers significant damage, affecting the global economy, and the United States enters into a recession. Spooked by the market turmoil, the U.S. administration backs down on the tariff sanctions and restarts a new round of negotiation with China. This scenario is not remote at all. Trade sanction is a costly punishment mechanism for the United States. A recent report by the U.S. Chamber of Commerce and the Rhodium Group estimates that the United States GDP could decrease by \$64-91 billion per year in the next four years, equivalent to 0.3-0.5 percent of the total U.S. GDP.²⁷³ Since September 2019, there has been a growing market consensus that the trade war is seriously damaging the U.S. market, and speculation abounds that the U.S.-

269. *Id.*

270. *Id.*

271. Zhiwu Chen & Heribert Dieter, *Trump Won Trade War 1.0—Will He Now Rush A Deal?*, ASIA PERSP. (Sept. 20, 2019), <https://www.asiaglobalinstitute.hku.hk/news-post/trump-won-trade-war-10-will-he-now-rush-deal>.

272. *Id.*

273. Chamber of Commerce of the United States of America and Rhodium Group, *Assessing the Costs of Tariffs on the U.S. ICT Industry: Modeling U.S.-China Tariffs* (Mar. 15, 2019), <https://rhg.com/research/assessing-the-costs-of-tariffs-on-the-us-ict-industry>; see also Trade Partnership Worldwide, LLC, *Estimated Impacts of Tariffs on the U.S. Economy and Workers*, TRADEPARTNERSHIP.COM (Feb. 2019), <https://tradepartnership.com/reports/estimated-impacts-of-tariffs-on-the-u-s-economy-and-workers-2019>.

China trade war will drive the U.S. economy to the brink of recession.²⁷⁴

Thus, even if an enforcement mechanism is incorporated into the final trade agreement, it is not irreversible and there is no guarantee that the punishment will be implemented. The United States has left too much discretion for itself in determining whether and how to carry out the threat in case of China's breach of contract.²⁷⁵ This undermines its credibility—China therefore reckons that the United States will be unlikely to enforce its threat of trade sanctions on China when the time comes, as doing so could have significant political and economic ramifications for the United States.²⁷⁶ Since the United States has problems committing to its punishment mechanism, there seems to be little benefit in incorporating such an enforcement mechanism in the first place. Indeed, the United States' insistence on such a mechanism has caused significant disagreement and delay in the negotiation between the two countries and is one of the major factors contributing to the current impasse.²⁷⁷

V. THE PRICE OF DIGNITY

The cost of writing the contract further contributes to the incompleteness of the Sino-U.S. trade agreement. The trade war did not occur in a vacuum but against a backdrop of growing unease and anxiety about China's rise in American society. As the rigid contract that the United States is demanding appears imbalanced and is highly visible to the Chinese audience, this could entail a loss of dignity to the Chinese government. Indeed, the trade talk not only involves economic

274. Dion Rabouin, *Trump's Trade War Is Being Felt Throughout the Economy*, AXIOS (Sept. 12, 2019), <https://www.axios.com/trumps-trade-war-is-being-felt-throughout-the-economy-cf192439-cd83-4bfa-a9b8-a28e4659d8b1.html>; Jonathan Garber, *US-China Trade War May Drive Economy to Brink of Recession*, FOX BUS. (Sept. 4, 2019), <https://www.foxbusiness.com/economy/us-china-trade-war-economy-recession-impact>; John Cassidy, *Will Trump Back Down as His Trade War with China Bites the U.S. Economy?*, NEW YORKER (Sept. 4, 2019), <https://www.newyorker.com/news/our-columnists/will-trump-back-down-as-his-trade-war-with-china-bites-the-us-economy>.

275. SCHELLING, *supra* note 26, at 40 ("It is essential, therefore, for maximum credibility, to leave as little room as possible for judgement or discretion in carrying out the threat.")

276. *Id.* ("If one is committed to punish a certain type of behaviour when it reaches certain limits, but the limits are not carefully and objectively defined, the party threatened will realize that when the time comes to decide whether the threat must be enforced or not, his interest and that of the threatening party will coincide in an attempt to avoid the mutually unpleasant consequences.")

277. Rappeport, *supra* note 10.

interests, but also concerns national pride and dignity.²⁷⁸ Economists have long found that the concern with pride and dignity can lead people to a negotiation impasse and to shift the blame onto others.²⁷⁹ Acceding to the U.S. demand would send a signal to the Chinese people that China is the loser in the bargain and that the government is too weak to stand up to foreign aggression. This would directly threaten the legitimacy of the CCP. In the following sections, I will first explain how the self-serving bias can lead the negotiating parties into an impasse. I will then move on to explain how China's long and painful history of subjugation to western powers becomes a constraint for the Chinese government in acceding to the U.S. demand.

A. *Self-Serving Bias*

Behavioral economists have identified the self-serving bias, the tendency for parties to make decisions that conflate what is fair with what benefits oneself, as a major cause of bargaining impasse.²⁸⁰ Research has shown that bargainers not only care about what the other party offers, but also the other party's motives.²⁸¹ People will deem it fair to be nice to those who are nice to them, and to be mean to those who are mean to them.²⁸² Emotions therefore matter in a negotiation.²⁸³ An aggressive bargaining can be interpreted as an exploitative attempt to gain an unfair advantage over the other party, rather than an attempt to get what the party perceives as fair.²⁸⁴

278. Pallavi Gogoi, *Analysis: The Politics of National Humiliation in the Trump-Xi Meeting*, NPR (June 25, 2019), <https://www.npr.org/2019/06/25/735274808/analysis-the-politics-of-national-humiliation-in-the-trump-xi-meeting>.

279. Roland Benabou & Jean Tirole, *Identify, Dignity and Taboos: Beliefs as Assets*, (IZA Inst. of Labor Econ., Discussion Paper No. 2583, 2007).

280. See generally Linda Babcock, George Loewenstein, Samuel Issacharoff & Colin Camerer, *Biased Judgements of Fairness in Bargaining*, 85 AM. ECON. REV. 1337 (1995); see also Linda Babcock, Xianghong Wang & George Loewenstein, *Choosing the Wrong Pond: Social Comparisons in Negotiations that Reflect a Self-Serving Bias*, 111 Q. J. ECON. 1 (1996); Linda Babcock & George Loewenstein, *Explaining Bargaining Impasse: The Role of Self-Serving Biases*, 11 J. ECON. PERSP. 109 (1997).

281. See generally Matthew Rabin, *Incorporating Fairness into Game Theory and Economics*, 83 AM. ECON. REV. 1281 (1993); Sally Blount, *When Social Outcomes Aren't Fair: The Effect of Causal Attributions on Preferences*, 63 ORG. BEHAV. & HUM. DECISION PROCESSES 131 (1995); John H. Kagel, Chung Kim & Donald Moser, *Fairness in Ultimatum Games with Asymmetric Information and Asymmetric Payoffs*, 13 GAMES & ECON. BEHAV. 100 (1996).

282. Rabin, *supra* note 281, at 1281.

283. *Id.*

284. Babcock & Loewenstein, *supra* note 280, at 110.

The United States and China have divergent beliefs of what they think that they are entitled to and what they perceive as fair. For more than a thousand years until the end of the seventeenth century, China was one of the most advanced and powerful nations in the world.²⁸⁵ In 1820, China accounted for a third of the global GDP and dominated the world economic landscape.²⁸⁶ However, the country began to lag behind in the eighteenth century, while the West was achieving impressive technological developments with the beginning of the Industrial Revolution.²⁸⁷ By the mid-nineteenth century, China fell behind as a backward agrarian country.²⁸⁸ Therefore, the Chinese are indomitably determined to reclaim their past glory²⁸⁹ and they think their country “morally deserves its moment of renaissance after its terrible modern history.”²⁹⁰ As Chinese President Xi Jinping put it: “To realize the renaissance of the Chinese nation is the greatest dream for the Chinese nation in modern history.”²⁹¹

To achieve its rejuvenation as a great nation, the Chinese leadership has deemed innovation and technological development as the top priority.²⁹² Indeed, despite its huge trade surplus with western countries, China serves as the world’s factory for low-value products, whereas the greatest profits are reaped by foreign companies.²⁹³ Driven by a growing disillusionment with the inability of Chinese companies to capture

285. JUSTIN Y. LIN, *DEMISTIFYING THE CHINESE ECONOMY* 55 (2011).

286. *Id.* at 1.

287. *Id.* at xiv.

288. *Id.* at 55.

289. GRAHAM ALLISON, *DESTINED FOR WAR: CAN AMERICA AND CHINA ESCAPE THUCYDIDES’S TRAP?* 107 (2017).

290. Alice Su, *As Trade War Escalates, Chinese Remember “National Humiliation”*, L.A. TIMES (May 13, 2019), <https://www.latimes.com/world/la-fg-china-trade-war-tariffs-colonialism-humiliation-20190513-story.html> (quoting Kerry Brown, noting that “the biggest perception gap between the United States and China lies in both sides’ sense of entitlement . . . China feels like it morally deserves this moment of renaissance after its terrible modern history, and doesn’t feel like the West has the right to stop it. America feels like it’s been giving too much and never been getting what it really wanted.”).

291. Cary Huang, *Just What is Xi Jinping’s Chinese Dream and Chinese Renaissance?*, S. CHINA MORNING POST (Feb. 6, 2013), <https://www.scmp.com/news/china/article/1143954/just-what-xi-jinpings-chinese-dream-and-chinese-renaissance>.

292. See Chris Buckley, *Xi Urges Greater Innovation in “Core Technologies”*, N.Y. TIMES (June 10, 2014), <https://sinosphere.blogs.nytimes.com/2014/06/10/xi-urges-greater-innovation-in-core-technologies/> (noting that the CCP’s policy of encouraging “indigenous technologies” dated back to Jiang Zemin).

293. Thomas Hout & Pankaj Ghemawat, *China vs the World: Whose Technology Is It*, HARV. BUS. REV. (Dec. 2010), <https://hbr.org/2010/12/china-vs-the-world-whose-technology-is-it>.

a larger share of the high-tech industries,²⁹⁴ the Chinese leadership trumpeted the goal of making China the “master of its own technologies,” urging greater innovation in core technologies.²⁹⁵ President Xi also believed that China has an inherent comparative advantage over its western counterparts due to its concentration of power and its ability to pool resources.²⁹⁶ It is against this background that China promulgated China 2025, an industrial policy plan that aims to close the gap with western high-tech prowess and lessen China’s dependence on imported technology.²⁹⁷

But many in America, including President Trump, believe that China’s rise in technology poses a threat to the United States and challenges its status as the global hegemon.²⁹⁸ For the first time in the past four decades, the United States sees China as a serious rival that must be contained and beaten.²⁹⁹ The United States is particularly wary of the 2025 Report, which outlines China’s ambition to be a technology superpower.³⁰⁰ The United States sees China as leveraging such technology superpower to move itself closer to the world’s center stage.³⁰¹ It has accused China of using government subsidies, mobilizing state-owned enterprises, and implementing forced technology transfer to

294. *Id.*

295. Robert D. Atkinson, *China’s Strategy for Global Technology Dominance by Any Means Necessary*, FORBES (Nov. 12, 2015), <http://www.forbes.com/sites/realspin/2015/11/12/chinas-strategy-for-global-technology-dominance-by-any-means-necessary/#11b91b207242>.

296. ALLISON, *supra* note 289, at 124 (citing Xinghua, *Xi Sets Targets for China’s Science, Technology Mastery*, EN.PEOPLE.CN (May 30, 2016), <http://en.people.cn/n3/2016/0530/c90785-9065418.html>).

297. Zhongguo Zhizao 2025 (中国制造2025) [Notice on Issuing “Made in China 2025”] (promulgated by the State Council, May 8, 2015), 2015 STATE COUNCIL 28(China). See generally Max J. Zenglein & Anna Holzmann, *Evolving Made in China 2025: China’s Industrial Policy in the Quest for Global Tech Leadership*, MERCATOR INST. FOR CHINA STUD. (July 2, 2019), <https://merics.org/sites/default/files/2020-04/MPOC%20Made%20%20in%20China%202025.pdf>.

298. Peter Navarro, *Trump’s Tariffs Are A Defense Against China’s Aggression*, WALL STREET J. (June 20, 2018), <https://www.wsj.com/articles/trumps-tariffs-are-a-defense-against-chinas-aggression-1529533046>. See generally Atkinson, Cory & Ezell, *supra* note 9; Robert D. Atkinson, *Enough Is Enough: Confronting Chinese Innovation Mercantilism*, THE INFO. TECH. & INNOVATION FOUND. (Feb. 2012), http://www2.itif.org/2012-enough-enough-chinese-mercantilism.pdf?_ga=2.126749709.1842093318.1593887421-249582046.1593887421.

299. Yuwen Deng, *The U.S. Sees the Trade War as A Tactic to Contain China. So Does Beijing*, S. CHINA MORNING POST (July 4, 2018), <https://www.scmp.com/comment/insight-opinion/united-states/article/2153587/us-sees-trade-war-tactic-contain-china-so-does>.

300. USTR, *supra* note 9, at 10–16.

301. *Id.*

achieve its ambitious 2025 plan.³⁰² It has further claimed that these tactics undermine China's stated commitments to the international trade rules and pose a security threat.³⁰³ In recent years, the United States has limited Chinese investment in key U.S. technology sectors, blocked Huawei and ZTE from doing businesses in the U.S. markets, and introduced measures to control the sale of critical technologies.³⁰⁴ On July 6, 2018, the Trump administration started implementing twenty-five percent tariffs on \$34 billion worth of Chinese goods, targeting 818 products central to the Made in China 2025 initiative.³⁰⁵

Thus, many in China see the United States as invoking the trade war to contain China and to prevent it from rising up to be a superpower that will rival the United States.³⁰⁶ As the *Global Times* remarked: "The root cause of the deterioration of Sino-U.S. relations is that China's rise has reached a level that the United States cannot accept. . . the strategic resistance of the United States to China's rise is hard to change."³⁰⁷ Chinese policymakers and analysts overwhelmingly believe that Washington is pursuing a strategy of containment to slow China's progress in science and technology and that trade is not the real target.³⁰⁸ Such a belief is also shared among many American intellectuals.³⁰⁹ The arrest of Meng Wanzhou, chief financial officer (CFO) of Huawei

302. Melissa Cyrill, *What Is Made in China 2025 and Why Has It Made the World So Nervous*, CHINA BRIEFING (Dec. 28, 2018), <https://www.china-briefing.com/news/made-in-china-2025-explained/>; Alice Tse & Jullianna Wu, *Why "Made in China 2025" Triggered the Wrath of President Trump*, S. CHINA MORNING POST (Sept. 11, 2018), <https://multimedia.scmp.com/news/china/article/made-in-china-2025/index.html>.

303. James McBridge & Andrew Chatzky, *Is "Made in China 2025" A Threat to Global Trade?*, COUNCIL ON FOREIGN REL. (May 13, 2019), <https://www.cfr.org/backgrounder/made-china-2025-threat-global-trade>.

304. Adam Segal, *Seizing Core Technologies: China Responds to US Technology Competition*, CHINA LEADERSHIP MONITOR (June 1, 2019), <https://www.wita.org/nextgentrade/china-responds-u-s-tech-competition/>.

305. *Id.*

306. Deng, *supra* note 299.

307. Hu Xijin, WEIBO (Oct. 8, 2018, 9:35 PM), <https://m.weibo.cn/status/4292963502736291>; *see also* Segal, *supra* note 304.

308. *See* Segal, *supra* note 304.

309. *See generally* Geoffrey Garrett, *Why the U.S.-China "Trade War" Is Really About the Future of Innovation*, KNOWLEDGE@WHARTON (Apr. 9, 2018), <https://knowledge.wharton.upenn.edu/article/u-s-china-trade-war-really-future-innovation/> (" . . . what is really going on is not about trade; it is about who will lead global innovation in the 21st century."); Stephen S. Roach, *Japan Then, China Now*, PROJECT SYNDICATE (May 27, 2019), <https://www.project-syndicate.org/commentary/for-america-china-is-the-new-japan-by-stephen-s-roach-2019-05?barrier=accesspaylog> (noting that Americans have made China the villain just as it portrayed Japan as the greatest economic threat to the United States three decades ago).

Technologies Co., in Canada in December 2018 further fueled such public sentiments.³¹⁰ On May 15, 2019, the U.S. Department of Commerce further restricted the sales of U.S. technology to Huawei when such “sale or transfer would harm U.S. national security or foreign policy interests.”³¹¹ Many Chinese see the anti-Huawei offensive as further evidence that the United States is trying to stop China’s rise.³¹² Given the domestic political sentiment against the United States, the Chinese government will need to appear tough in defending China’s interests. Accordingly, it will be extremely challenging for Chinese negotiators to agree to the rigid terms that the United States is currently demanding.

B. *The Historical Memory*

China’s historical memory further constrains the Chinese government’s capacity to make concessions to the United States. In March 2018, when the U.S. delegates first presented their demands to their Chinese counterparts,³¹³ it immediately touched off the Chinese people’s sense of historical suffering and fighting spirit.³¹⁴ Even Martin Wolf, the chief economic commentator for *The Financial Times*, has called the U.S. demands a “humiliation” for China.³¹⁵ *Global Times*, a party mouthpiece, lambasted the U.S. request as outrageous and accused the United States of mistaking China for the country that it was in 1840.³¹⁶ Behind China’s strong pushback is China’s painful

310. Isabel Hilton, *The Huawei Story*, PROSPECT MAG., July 18, 2019 (noting that the United States wanted to extradite Ms. Meng, the daughter of Ren Zhenfei, the founder of Huawei, for allegedly violating US sanctions on Iran).

311. U.S. Department of Commerce, Department of Commerce Announces the Addition of Huawei Technologies Co. Ltd. to the Entity List (May 15, 2019), <https://www.commerce.gov/news/press-releases/2019/05/department-commerce-announces-addition-huawei-technologies-co-ltd>.

312. Hilton, *supra* note 310.

313. *Statements of the United States Regarding China Talk*, THE WHITE HOUSE (Jan. 31, 2019), <https://www.whitehouse.gov/briefings-statements/statement-united-states-regarding-china-talks/>.

314. Tian Feilong, *To Rise Above Trump’s Trade War, China Should Let Go of Its “Century of Humiliation”*, S. CHINA MORNING POST (Sept. 26, 2018), <https://www.scmp.com/comment/insight-opinion/united-states/article/2165675/rise-above-trumps-trade-war-china-should-let>.

315. Martin Wolf, *Donald Trump Declares Trade War on China*, FIN. TIMES (May 8, 2018) (“No great sovereign power could accept such a humiliation. For China, it would be a modern version of the ‘unequal treaties’ of the 19th century.”), <https://www.ft.com/content/dd2af6b0-4fc1-11e8-9471-a083af05aea7>.

316. Rappoport, *supra* note 10.

experience of the “century of humiliation,” marked by military defeats, economic colonization, and political subjugation.³¹⁷

In the early 1830s, a large trade deficit existed between Britain and China—Britain purchased large quantities of Chinese silk and tea while China bought little in return.³¹⁸ Britain then decided to smuggle Indian opium into China, and the Qing government resisted.³¹⁹ In 1839, the British sent gunboats to compel China to open their ports and markets to the opium trade, triggering the First Opium War.³²⁰ After its military failure, China signed the Treaty of Nanking with Britain.³²¹ China was forced to open several new trade ports, allowing British merchants to trade with low tariffs and extraterritorial privileges.³²² China also handed over control of Hong Kong to Britain.³²³ By the 1950s, China had signed similarly unequal treaties with the United States, Russia, and France, and China continually ceded and leased territories to foreign powers.³²⁴ When the CCP rose to power in 1949, it vowed to end the century of national humiliation by western powers.³²⁵ In fact, the CCP portrayed itself as the only modern Chinese political party with the power to stand up to foreign aggression.³²⁶ Every school-child in China was taught the shameful experience of this “century of humiliation” and learned the mantra “never forget our national humiliation.”³²⁷

Not surprisingly, hardline sentiments in China have been growing since the trade war erupted.³²⁸ In June 2018, China relaxed investment restrictions on foreign companies in twenty-two areas including

317. *Id.*

318. ZHENG WANG, NEVER FORGET NATIONAL HUMILIATION: HISTORICAL MEMORY IN CHINESE POLITICS AND FOREIGN RELATIONS (CONTEMPORARY ASIA IN THE WORLD) 49 (2014).

319. *Id.*

320. *Id.* at 49–50.

321. *Id.* at 50.

322. *Id.* at 61.

323. *Id.*

324. *Id.* at 61–66.

325. Susan L. Shirk, *Changing Media, Changing Foreign Policy in China*, 8 JAPANESE J. POL. SCI. 43, 43–70 (2007).

326. *The “Century of Humiliation” and China’s Narratives, Hearing Before the U.S.-China Econ. and Sec. Review Comm’n on “China’s Narratives regarding National Security Policy”*, 112th Cong. 140 (Mar. 10, 2011) (statement of Alison A. Kaufman, Research Analyst).

327. ALLISON, *supra* note 289, at 113.

328. Lingling Wei & Bob Davis, *Trump, Xi Face Pressure at Home over Trade: Concerns Are Rising at Home that Xi Jinping and President Trump Will Try to Make A Quick Deal*, WALL STREET J. ONLINE (Feb. 20, 2019), <https://www.wsj.com/articles/warriors-on-trade-trump-and-xi-face-a-similar-challenge-at-home-11550709127>.

automobiles, banks, securities, electricity grids, etc.³²⁹ Some have called these new measures the “22 demands,” comparing them to the twenty-one demands that the Japanese government imposed on China in 1915 during World War I.³³⁰ Chinese nationalists were angry with Liu He, the vice premier and chief Chinese negotiator, for making too many concessions to the United States.³³¹ They made unflattering comparisons between Liu He and Li Hongzhang, a powerful Qing dynasty figure who was labeled a “traitor” for signing the humiliating treaty with Japan in 1895 that ended the first Sino-Japanese war.³³²

The Chinese government’s sensitivity toward the issue of dignity was revealed during the Sino-U.S. trade negotiations in the 1990s. Although China offered extraordinary concessions, all three trade agreements that were signed during this period were informal. The 1991 agreement was in the form of an MOU, the 1995 agreement was an exchange of letters, and the 1996 agreement was a report.³³³ Among them, the 1995 agreement offers the starkest example. First, the agreement was structured as an exchange of letters between then-Premier Wu Yi and the then-USTR representative. For the Chinese, this was a face-saving tactic. China did not want another MOU, as it would suggest that it had failed to implement the previous 1992 MOU and was now forced into signing another one.³³⁴ The form of an exchange of letters was a way to downplay the importance of the agreement in front of the domestic audience. Moreover, most of the details of the Chinese concessions were tucked into the Action Plan, which was attached as an annex to Wu Yi’s letter, thus further obscuring the concessions that China had made.³³⁵

In the current trade negotiation, however, the United States is unwilling to compromise on the form of the agreement. First, the United States wants the agreement to look very hawkish, while China wants to

329. *China’s New ‘Negative List’*, FRESHFIELDS BRUCKHAUS DERINGER (July 11, 2018) [hereinafter FRESHFIELDS BRUCKHAUS DERINGER], http://knowledge.freshfields.com/m/Global/r/3792/china_s_new_negative_list_.

330. Zhen Yan, *Cong 1915 Nian De 21 Tiao Dao 2018 Nian de 22 Tiao* (从1915年的“21条”到2018年的“22条”) [From the “21 Demands” in 1915 to the “22 Demands” in 2018], REDCHINACN (July 16, 2018), <http://www.redchinacn.org/portal.php?mod=view&aid=36065>.

331. Katsuji Nakazawa, *The Embattled Envoy: Xi Critics Take Aim at Trade Negotiator Liu He*, NIKKEI ASIAN REV. (Feb. 28, 2019), <https://asia.nikkei.com/Editor-s-Picks/China-up-close/The-embattled-envoy-Xi-critics-take-aim-at-trade-negotiator-Liu-He>.

332. *Id.*

333. Massey, *supra* note 121.

334. MERTHA, *supra* note 122, at 14.

335. *See* 1995 Agreement, *supra* note 123.

downplay the formality of the agreement. As Liang Ming, director of the institute of international trade at the Ministry of Commerce, noted: “China does not want to see many strong and forceful words such as ‘must’ and ‘should’ in the trade agreement, and seek[s] a more balanced text.”³³⁶ Form is very important for the Chinese leadership, as the language of the texts could stir up public sentiments and threaten the legitimacy of the Chinese government. However, the United States insists that China write into law the promises that it makes in the agreement as part of the negotiation.³³⁷ Writing the agreement into law touches a sensitive nerve in China and is deeply offensive to many Chinese.³³⁸ That explains why the Chinese government wants to accomplish such changes through the State Council or Ministry decrees, which are less visible.³³⁹

Second, the United States insists upon an enforcement mechanism that guarantees China’s full performance of the agreement. However, none of the three previous Sino-U.S. IPR trade agreements in the 1990s included contingency clauses for enforcement. Instead, renegotiation was used as a substitute for the deliberate omission of the enforcement mechanism.³⁴⁰ In fact, the USTR had expected that China would only partially implement its agreements signed in the 1990s.³⁴¹ When China was found to be in violation of the agreement, the two countries would find themselves back to the negotiation table.³⁴² Thus, these types of trade agreements are constantly renegotiated. In this round of the trade talks, however, the U.S. administration called for an enforcement mechanism that would allow the United States to impose unilateral tariffs that cannot be counteracted by a tariff from China.³⁴³ Such an aggressive request, for many Chinese people, aroused the stinging memories of unequal treaties that China signed with western powers in the nineteenth century.³⁴⁴ A member of the Chinese negotiation team

336. Evelyn Cheng, *As Trump Demands Major Concessions, Beijing Wants the World to Think that the US will Blink First*, CNBC (June 14, 2019), <https://www.cnbc.com/2019/06/14/us-china-trade-beijing-wants-world-to-think-washington-will-back-down.html>.

337. Pamuk & Blanchard, *supra* note 97.

338. Jack Perkowski, *U.S.-China Trade War: It’s Time for A Change in Strategy*, FORBES (Aug. 18, 2019) (arguing that a legalistic approach does not work), <https://www.forbes.com/sites/jackperkowski/2019/08/18/u-s-china-trade-war-its-time-for-a-change-in-strategy/#3820d6776baf>.

339. *Id.*

340. Steve Shavell, *The Design of Contracts and Remedies for Breach*, 99 Q.J. ECON. 121, 141–45 (1984).

341. Mertha & Pahre, *supra* note 173, at 718.

342. *Id.*

343. Rappoport, *supra* note 10.

344. *Id.*

was also quoted as feeling “humiliated” by the aggressive U.S. requirement for quarterly compliance reviews by independent organizations.³⁴⁵ The USTR has therefore underestimated the price of dignity for the Chinese negotiators. If the Chinese government caves to the U.S. demand for a one-sided enforcement mechanism, it will not only look weak, but the national humiliation could also cause social instability that would threaten the legitimacy of the CCP.³⁴⁶

VI. USING HOSTAGES TO FACILITATE COOPERATION

Driven by a legalistic approach, the U.S. trade negotiators are attempting to write a rigid contract that incorporates as many details as possible into the trade agreement. As a rigid contract reduces China’s discretion in executing the agreement, the Trump administration has hoped that this would curb China’s opportunistic behavior and commit China to its promises. However, a rigid contract remains incomplete. This brings us to an important question: is there any alternative solution for the United States to more credibly bind China to its commitment?

Indeed, the crux of the problem in the current Sino-U.S. trade conflict essentially boils down to the following question: how can two countries who distrust each other resolve their conflict and have a peaceful and constructive commercial relationship? It is important to first recognize that the Sino-U.S. conflict is a variable sum game rather than a zero-sum game—that is, the sum of the gains for the players is not fixed, and the gain of one player does not necessarily mean the loss for the other.³⁴⁷ As in many international conflicts, “there is a common interest in reaching outcomes that are mutually advantageous.”³⁴⁸ However, there is no international court, arbitration tribunal, or any third party that has the authority to intervene in case of contract breach. If China violates the agreement, the only recourse for the United States is to terminate the agreement.³⁴⁹

Thomas Schelling has identified some common features between international relations and the underworld.³⁵⁰ Similar to the Sino-U.S. conflict, trust and good faith are lacking among gangs and ancients,

345. Perkowski, *supra* note 338.

346. Gogoi, *supra* note 278.

347. SCHELLING, *supra* note 26, at 5.

348. *Id.*

349. *See* Telser, *supra* note 228, at 27.

350. SCHELLING, *supra* note 26, at 20.

and there is no neutral third party that adjudicate their disputes.³⁵¹ The strategies that were traditionally employed to avoid conflict include exchanging hostages, drinking wine from the same glass to demonstrate it is safe from poison, and even exchanging spies to facilitate the transmittal of information.³⁵² Such private ordering has clear economic rationale—Oliver Williamson has long pointed out that the institution of hostage-taking is efficient as it helps facilitate trade between parties when trust is lacking.³⁵³ Economic hostage-exchange can be viewed as a form of preemptively committing to abide by the terms of the negotiated agreements and to abstain from opportunistic behavior.³⁵⁴ Giving hostages raises the cost of opportunism and signals an intent not to behave opportunistically.³⁵⁵ The provision of hostages can take various forms. Economic integration, broadly speaking, is a form of giving hostages. The more integrated and interdependent are the Chinese and United States economies, the more hostages that each country then will have of each other. As remarked by Judge Posner, the fact that China is willing to invest in the United States is a hopeful sign for the Sino-U.S. relationship, as otherwise it would not be willing to spend so much on assets that are ultimately under the control of the U.S. government.³⁵⁶

Consider Huawei, a prominent example of an economic hostage. On December 1, 2018, Meng Wanzhou, Huawei's CFO, was arrested in Canada upon an extradition request from the U.S. Department of Justice (DOJ). The DOJ alleged that Huawei had engaged in a fraudulent financial scheme that violated U.S. export laws.³⁵⁷ The fact that the United States was able to charge Huawei for criminal violation of U.S. laws has to do with economic integration—Huawei's business presence in the United States, as well as its banking activities through U.S.

351. *Id.*

352. *Id.*

353. Williamson, *supra* note 26, at 521–22.

354. Yarbrough & Yarbrough, *supra* note 35, at 10.

355. *Id.*

356. *See generally* RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 1001 (9th ed. 2014). Posner's remarks were made in the context of his comments on China National Offshore Oil Corporation (CNOOC), a Chinese state-owned oil and gas company's failed attempt to acquire assets from Unocal.

357. The United States Department of Justice, Chinese Telecommunications Conglomerate Huawei and Huawei CFO Wanzhou Meng Charged with Financial Fraud (Jan. 28, 2019), <https://www.justice.gov/opa/pr/chinese-telecommunications-conglomerate-huawei-and-huawei-cfo-wanzhou-meng-charged-financial>.

financial institutions has subjected it to U.S. long-arm jurisdiction.³⁵⁸ In fact, all the Chinese companies that are conducting businesses in the United States can be held hostage by the U.S. government, as they need to comply with U.S. laws and regulations. For instance, Chinese companies listed in the U.S. stock exchanges, many of them state-owned, have voluntarily bound themselves to the higher standard of U.S. accounting and transparency requirements. Steinfeld suggests that in doing so, the Chinese government is outsourcing the governance of its national champions to U.S. legal institutions.³⁵⁹ In a similar vein, American companies doing business in China can also be held hostage. Qualcomm, a company that derives more than sixty percent of its revenue from the Chinese market, represents a stark example.³⁶⁰ In 2015, the company was subject to almost a \$1 billion fine for antitrust violations in China and volunteered to give a thirty-five percent discount for some of its products.³⁶¹ Qualcomm's proposed acquisition of NXP recently collapsed due to its delay in obtaining merger approval from China, despite approvals that it had obtained in eight other jurisdictions, with China being the only jurisdiction to hold up the deal.³⁶²

Conversely, decoupling the Sino-U.S. economy is dangerous: when neither side has hostages from each other, it is less likely for the two sides to build trust and more likely for conflicts to arise. Thus, the United States should welcome more economic exchange with China, particularly Chinese investments in the United States. Such investments constitute a provision of hostage-exchange that can bind China more credibly to its promises and can give the United States more leverage over China in a bargain. In fact, this seems to be exactly the strategy that the Chinese government has adopted. Despite the deteriorating Sino-U.S. relationship, the Chinese government has not shut its door to curb foreign investments in China. Recent years have witnessed China's accelerated efforts of opening up and cutting access restrictions for

358. *United States v. Huawei Tech. Co., Ltd.*, No. 18CR457S2AMD, 2020 WL 903007 (E.D.N.Y. 2019).

359. EDWARD S. STEINFELD, *PLAYING OUR GAME: WHY CHINA'S RISE DOESN'T THREATEN THE WEST* 32–35 (2010).

360. Luke Lango, *While Its Future Is Bright, Qualcomm Stock Isn't Done Falling Yet*, INVESTORPLACE (May 23, 2019), <https://investorplace.com/2019/05/future-bright-qualcomm-stock-falling/>.

361. Patrick Moorhead, *Qualcomm Settlement with China's NDRC Removes Major Speedbump*, FORBES (Feb. 10, 2015), <https://www.forbes.com/sites/patrickmoorhead/2015/02/10/qualcomm-settlement-with-chinas-ndrc-removes-major-speedbump/#4b42046b431a>.

362. Sherisse Pham, *China Kills Qualcomm's 44 Billion Deal for NXP*, CNN (July 26, 2018), <https://money.cnn.com/2018/07/26/technology/qualcomm-nxp-merger-china/index.html>.

foreign investors.³⁶³ Unfortunately, the Trump administration is doing just the opposite—the various measures and policies that it has adopted are driving the Sino-U.S. economy toward the direction of decoupling.

In an attempt to undermine China's economic power, the Trump administration imposed tariffs on Chinese imports to force U.S. businesses to reallocate their supply chains and shift their production out of China.³⁶⁴ This has created an exodus for manufacturers moving their production from China to other South Asian countries.³⁶⁵ In a survey conducted by the American Chamber of Commerce in August 2018, nearly one-third of the American businesses have relocated or are considering moving their manufacturing facilities out of China.³⁶⁶ Meanwhile, Chinese technology companies such as Huawei and other artificial intelligence companies have been restricted from commercial dealings with U.S. companies.³⁶⁷ This has forced them to move toward “de-Americanization” to decouple themselves from American supplies.³⁶⁸ News has been spreading that the Trump administration is pondering blocking Chinese companies from listing in the U.S. stock exchanges.³⁶⁹ The White House is also considering limiting U.S. pension funds' investments in Chinese stocks, and possibly blocking all U.S. financial investments in China.³⁷⁰ The threat of financial decoupling

363. China's nationwide negative list of restricting foreign investment was cut down to 40 in 2019, compared to 63 in 2017. See FRESHFIELDS BRUCKHAUS DERINGER, *supra* note 329 (noting that the nationwide negative list was cut down to 48 in 2018 from 63 in 2017); *China Focus: China Opens More Sectors to Foreign Investment with New Negative Lists*, XINHUA (June 30, 2019), http://www.xinhuanet.com/english/2019-06/30/c_138186392.htm (noting the nationwide negative list was cut down to 40 in 2019 from 48 in 2018).

364. Chen & Dieter, *supra* note 271.

365. Chad Bray, *US-China Trade War Pushes Firms to Accelerate Supply Chain Shift to Asean*, *Citygroup Says*, S. CHINA MORNING POST, Nov. 5, 2018; He Huiwei, *US-China Trade War Manufacturing Exodus Creating Boom Times for Chinese Logistics Companies*, S. CHINA MORNING POST, May 22, 2019.

366. American Chamber of Commerce, *Impact of U.S. and Chinese Tariffs on American Companies in China* (Sept. 14, 2018), <https://www.amcham.org.hk/uploads/media/default/0001/06/d3d0a9be63167067f12a8b09099823e8afa55b45.pdf>.

367. David Shepardson & Josh Hortwitz, *U.S. Expands Blacklist to Include China's Top AI Startups Ahead of Trade Talks*, REUTERS (Oct. 8, 2019), <https://www.reuters.com/article/us-usa-trade-china-exclusive/us-widens-blacklist-to-include-chinas-top-ai-startups-ahead-of-trade-talks-idUSKBN1WM25M>.

368. Cheng Ting-fang & Lauly Li, *Inside Huawei's Secret Plan to Beat American Trade War Sanctions*, NIKKEI ASIAN REV., Sept. 11, 2019.

369. Alan Rappeport & Ana Swanson, *White House Weighs Block Chinese Companies from U.S. Exchanges*, N.Y. TIMES, Sept. 28, 2019.

370. Maggie Fitzgerald, *Trump Administration Reportedly Considered Limits on Pension Investment in Chinese Stocks*, CNBC (Oct. 8, 2019), <https://www.cnn.com/2019/10/08/trump-administration-reportedly-considering-limits-on-pension-investments-in-chinese-stocks.html>.

is deterring Chinese companies from seeking to tap into the U.S. capital market.³⁷¹ The tougher U.S. regulatory restrictions and a less hospitable investment environment are chilling Chinese investments.³⁷² Data collected by the Rhodium Group shows that Chinese foreign direct investment in the United States fell to only \$5.4 billion in 2018—an over eighty percent drop from \$29 billion in 2017.³⁷³ The Trump administration’s imposition of trade sanctions and a series of other restrictive measures on Chinese companies are pushing the U.S.-China relationship to the brink. As warned by Garrett: “Advocates promote decoupling in the name of national security. I believe the opposite would be true. Decoupling would profoundly harm America’s national security by reducing the costs of war with China and hence making military conflict more likely.”³⁷⁴

VII. CONCLUSION AND POLICY IMPLICATIONS

Drawing upon the insights from contact theory, this Article proposes a framework for analyzing the incompleteness of trade agreements. In particular, it focuses on analyzing three ingredients of transaction costs that are barriers to drafting, concluding, and enforcing a rigid trade agreement. Using the U.S.-China trade negotiation as a comprehensive case study, this Article illustrates the circumstances when a trade agreement is difficult to write, unlikely to succeed and impossible to enforce. Corresponding to each of the three ingredients of transaction costs, this Article also offers concrete policy recommendations to the U.S. negotiators.

First, the U.S. government should not overestimate the benefits of forcing China to rewrite its national laws. This is not to say that legislative improvements are not helpful at all. China has made great strides in enhancing private enforcement of IPRs. However, the problem of slack Chinese IPR enforcement persists primarily due to the deficiency in administrative enforcement. Therefore, the U.S. priority should be

371. Chad Bray, *Can Trump Cut Off Chinese Companies from US Capital Markets Without Damaging American Capitalism*, S. CHINA MORNING POST, June 8, 2019; Samuel Shen & Josh Horwitz, *Chinese Companies Rethink U.S. IPOs After Trump’s Delisting Threat*, REUTERS (Sept. 30, 2019), <https://www.reuters.com/article/us-usa-china-listings-wariness/chinese-companies-rethink-us-ipos-after-trumps-delisting-threat-idUSKBN1WF18U>.

372. Alan Rappeport, *Chinese Money in the U.S. Dries Up as Trade War Drags On*, N.Y. TIMES, July 23, 2019.

373. See generally THILO HANEMANN, DANIEL H. ROSEN, CASSIE GAO & ADAM LYSENKO, US-CHINA INVESTMENT PROJECT, TWO-WAY STREET: 2019 UPDATE US-CHINA INVESTMENT TREND (2019), <https://rhg.com/research/two-way-street-2019-update-us-china-direct-investment-trends/>.

374. See Garrett, *supra* note 258.

to help China enhance due process and inject more transparency into the administrative process.

Second, as the Trump administration lacks commitment power to impose a sustained tariff sanction on China, there is little benefit in insisting upon a punishment mechanism in the first place. A more practical solution is to try to get as many concessions as possible from China before an agreement is signed. China is keen on securing a trade deal, as demonstrated by the spate of legal concessions it made during the spring of 2019. This is also face-saving for the Chinese government, as concessions that are made during the trade talks tend to be less visible than those that are incorporated into the agreement.

Third, the U.S. government should understand the semantic significance of the trade agreement, and its impact on the emotions and feelings of the Chinese people. The Chinese government does not want to be perceived as the loser in the bargain. For China to both satisfy U.S. demands and appease its domestic audience, it would make sense to downplay the form and the tone of the trade agreement in order to make it appear less formal and less rigid. A nod to the Chinese sensibilities will not materially affect the substance of the agreement but will greatly facilitate the talks and reduce the transaction cost for the Chinese government in acceding to U.S. demands.

Above all, the U.S. administration needs to recognize the limit of what it could achieve through a trade agreement. As Mark Wu asserted: “[W]e ought to abandon any pretense that commitments obtained through a trade agreement can solve problems once and for all.”³⁷⁵ A rigid contract cannot fundamentally resolve the moral hazard problem that the Trump administration has been concerned about, thus the marginal benefit of writing a rigid contract is rather small. As illustrated by the Sino-U.S. IPR negotiations in the 1990s, even if China gives up extraordinary legal concessions, a rigid trade agreement has little impact on actual enforcement. The transformation of China’s IP legal regimes did not stop the complaints from U.S. businesses, and the row between the two countries regarding IP protection continues to this day. The information asymmetry between the two sovereigns is far too high—it is not only costly for the United States to monitor and verify the conditions of compliance in China, it is also difficult for China’s central government to effectively bind its local governments to adequate compliance.

In short, from an economic standpoint, the U.S. negotiators have overestimated the benefits of a rigid agreement while underestimating

375. *Wu Testimony*, *supra* note 153, at 10.

its cost. In the presence of the prohibitively high negotiation and enforcement costs of a rigid trade agreement, the United States is better off allowing more flexibility in the agreement. While this would make it difficult for the Trump administration to claim a glorious political victory, it will significantly ease the tension between the world's two largest economies and allow global businesses to breathe a sigh of relief. That said, economics is not the sole consideration for central policymakers during a trade negotiation. A whole host of other factors involved in the Sino-U.S. relationship could play a role in affecting the negotiation outcome, and the Trump administration may well have other policy objectives in its calculation.³⁷⁶ This Article, elaborating on some of the challenges posed to the Sino-U.S. trade negotiation, is not in a position to predict whether the two sides will ultimately reach a comprehensive agreement or what the agreement will look like, nor is this the primary objective of this Article. The goal, however, is to expose an inconvenient truth of the trade war: economic sanction is unlikely to be an effective tool for dealing with the Sino-U.S. IPR disputes, whether the trade agreement ultimately culminated is written in a flexible or in a rigid manner. Indeed, contrary to the Trump administration's agenda to decouple the Sino-U.S. economy, this Article advocates instead for greater economic integration. By allowing each country to hold the other's assets hostage, economic integration can facilitate cooperation when trust is lacking. Therefore, integration is more conducive to promoting peace and prosperity in the Sino-U.S. relationship than a rigid trade agreement.

376. For instance, President Trump initially pressed for a rigid trade agreement in order to appear tough against a rising and assertive China. With re-election looming, he softened his stance by agreeing to a mini-deal, in an apparent attempt to appease his voters. See Heather Timmons & Andrea Shalal, *No "Phase Two" U.S.-China Deal on the Horizon, Officials Say*, REUTERS, Nov. 25, 2019.