U.S.-China Tech Policy & Business Impact

Prepared by Samm Sacks for the Canada China Business Council

April 2022

KEY TAKE-AWAYS

1. Beijing and Washington are rolling out policy and legal tools that aim to drive a wedge between the two economies and technology ecosystems. To be sure, these policy/legal tools emerge from distinct political systems and contexts; however, the two governments are increasingly mirroring each other through efforts to separate in areas including: export controls, supply chain security, restrictions in data flows, investment reviews, and industrial policies.

2. Multinational companies risk getting caught in the cross-fire—forcing internal discussions about possibilities for diversifying supply chains and high-end engineering.

3. Several signposts of crisis would signal disruption to this fragile status quo in U.S.-China commercial and investment ties, including: a Taiwan scenario, financial sanctions, and arrests of executives.

RISKS FROM WASHINGTON

Critics of the Biden administration's China policy have called the approach "Trump light" because it maintains a hawkish position in response to domestic political pressure to be confrontational. In the coming days/weeks, the administration is likely to release a new China strategy cementing such a hardline approach, a tone that will continue through the U.S. mid-term election and ramp up if there is a new president in 2024. **Overall, there is a trend toward "securitization" of the bilateral relationship—which means that national security has become the dominant lens through which U.S. policymakers view China and takes priority over other objectives.**

The Biden administration's intent, at a high level, is to "out compete" China by playing "offense" through investments in STEM, research & development, reshoring advanced manufacturing of semiconductors, and coordinating with allies and partners to set technology norms and governance standards that align with liberal democratic values.

Meanwhile, the administration has kept in place a number of policy and legal tools inherited from the Trump administration (largely due to domestic political pressure). There is debate between "hawks" and "pragmatists" within the interagency over how far to go in implementing these tools, leading to stalemate and creating uncertainty for multinational companies and investors. The main tools include:

- **Export Controls/Entity List designations**
  - o The Department of Commerce has become the centre of gravity in determining the scope of "decoupling" in the overall technology and business relationship.
  - o A trend started under the Trump administration is continuing with Biden in which the Entity List has been used a more expansive tool; however, to date only Chinese companies and their subsidiaries with clear evidence of ties to the military/surveillance-enabled human rights abuse have been identified on the list—in contrast to a so-called "seeing shadows on the wall" approach that would likely get pushback due to lack of evidence.
- **CFIUS**
  - o Long existing tool has created a deterrent chilling effect on inbound investment.
- **Executive Order Protecting America Citizen's Sensitive Data from Foreign Adversaries**
  - o Tremendous debate on how to implement this order as evidenced by deadlock over Commerce ICTS rule—significant pushback from industry due to farreaching authority granted to Commerce Dept to block any "transaction" deemed a national security threat.
- **Clean Network Initiative**
  - o Remains the de facto policy of the Biden administration despite no official statements.
  - o Goal is to rid Chinese hardware and software from global networks used by U.S. diplomatic/military communications.
- **Non-SDN Chinese Military Industrial Complex Companies List**
  - o Transferred out from purview of DOD to Treasury with an eye toward restricting U.S. investment from flowing to Chinese companies deemed to support China's PLA.

- o Xiaomi case from Trump administration served as a warning to Biden administration to show clear evidence of a Chinese company's ties to the defense industry before banning U.S. investment; U.S. policymakers do not want their bans to be rejected by federal courts as occurred previously.

- **Outbound Investment Screening**
  - o Among **most watched tools in play under debate right now; broad language in bipartisan innovation bill would potentially sweep in all outbound U.S. investment covering even investments in manufacturing and R&D facilities in China.**
  - o Biden administration may also issue a coming Executive Order calling for a new screening or review regime. **The key question is whether and to what extent the scope will be narrowed.**

RISKS FROM BEIJING

The Chinese government is undertaking a sweeping series of "crackdowns" (focused mainly on social media and internet platforms) with the aim of making the private sector carrying out the Party's vision for the economy and society. Chinese media refers to this campaign as "reform" rather than crackdown; multiple targets actually comprise the campaign with distinct sets of objectives and stakeholders involved.

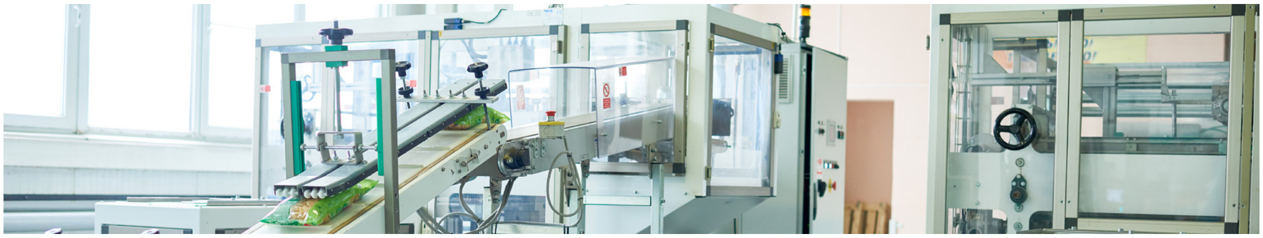
- **Key policy/legal tools:**
  - o Antimonopoly
  - o Data security (Data Security Law/Personal Information Protection Law)
  - o Online education
  - o Common Prosperity
- **Business Impact:**

  1. Foreign companies are not the focus of this campaign.

  2. Domestic suppliers, partners, or customers could be targets.

  3. The campaign could extend to foreign companies in the months ahead, but there are no signs this is happening.

The operating environment for foreign firms in China is growing more challenging, but "leaving China" is not so simple due to cost efficiencies, market opportunities, specialized manufacturing and engineering, complexity of relocating supply chains, etc. What is happening is a kind of "come to Jesus" conversation internally inside companies about where it may be beneficial to diversify, particularly focusing on reliance on high-end engineering in China. But any moves to diversity will take time and not be all or nothing.



SIGNPOSTS OF CRISIS

The fragile equilibrium of the status-quo could be disrupted by a number of black swan events, defined as low likelihood but high impact. These may include:

In the United States:

1. Designating Chinese companies to the Treasury Dept's SDN list, in effect banning them from transacting globally in USD. This would be a "nuclear option" causing massive disruption to the global economy, something even China hawks in DC are hesitant to do.
2. An accident at sea between the two militaries at a moment when both are operating in close proximity to one another with severely frayed high-level government-to-government communication channels.
3. Renewed calls by U.S. policymakers for regime change in Beijing, in ways that delegitimize the CCP leadership.

In China:

1. Investigations and raids of foreign companies in China would signal that Beijing no longer is concerned with alienating the western business community.
2. Arrests of U.S. executives at foreign companies in Beijing would have a chilling effect on bilateral commercial ties and create massive instability in the operating environment.
3. A PLA invasion of Taiwan or other economically coercive measures to retake the island would force multinationals to pick a side and curtail investment/market opportunities.