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What's Been Happening

1 — G7 Italy: Tough Stance on China Economic Policy and its Ties to Russia — 1

[**In One Sentence**]

- On June 14, the G7 countries issued their Apuila Leaders' Communique, which registered concerns about China's "persistent industrial targeting" and "comprehensive non-market policies and practices" which create "global spillovers, market distortions and harmful overcapacity" in sectors such as electric vehicles and clean-energy products.
- To counter China's "unfair competition" and "harmful overcapacity," the European Commission announced additional duties of about 38.1 percent on Chinese electric vehicles, following the United States' announcement of 100 percent tariff on Chinese EVs in May.
- The G7 countries also issued strong language against China for its support for Russia's illegal war in Ukraine and criticized China's "transfer of dual-use materials" to Russia's defense sector.
- The Chinese Foreign Ministry denounced the G7's "Chinese overcapacity' allegation" as "an excuse for protectionism" and warned that the G7 is "acting against the world trend of peaceful development."

[**Mark the Essentials**]

- In order to level the playing field and protect economic security, the G7 pledged to undertake "new monitoring and information sharing efforts" as well as update their respective toolkits to counter China's harmful policies and practices.
- The Biden administration reportedly spent considerable time and effort on pushing the G7 to take a tough stance on China, highlighting the need to protect domestic industries against China's trade and industrial policies as well as China's "partnership without limits" with Russia.
- Regarding China's "enabling" of Russia's war machine in Ukraine, the U.S. and EU have sanctioned Chinese companies and vowed to "continue taking measures" including secondary sanctions against financial actors in China that materially support Russia.
- While the G7 Communique took a tough stance on China's economic and trade practices, the communique also noted that the G7 countries seek "constructive and stable relations with China," "recognize the importance of direct and candid engagement," and "continue to engage [China] in areas of common interest."

[**Keeping an Eye On…**]

- Tough talk on China seems to come easily to the G7; tough measures that are taken in concert, well, not so much. On June 14, as per the White House's telling, President Joe Biden rallied his G7 colleagues to "work together to confront [China's] non-market policies and practices and efforts to dominate strategic sectors," including notably the electric vehicles (EV) sector. NSA Jake Sullivan even declared the G7 to be "more unified than they've ever been" on China economy-linked challenges. Problem is that just two days earlier, the European Commission issued its provisional countervailing duties on Chinese EV's following an anti-subsidy probe. The Commission's duties fly in the face of the 'ever more united' stance; indeed, the gap between the U.S. side and the European Union on Chinese EV's is as wide as the Atlantic. The Commission's peak provisional duty rate on Chinese EVs following the eight-month probe is two-fifths that of the United States; 38.1% v. 100%—Washington didn't even conduct an anti-subsidy probe prior to jacking up its tariffs. The rate on China's most nimble competitor in this space, BYD, at 17.4% is less than a fifth of the United States'. Second, the Commission's duties, once formally proclaimed, will be appealable by China to the Multi-Party Interim Arbitration Arrangement (MPIA) that 47 WTO members, including the EU and China, set up in 2020 as an alternative appeal process, now that Uncle Sam has crushed the original WTO dispute settlement appeals process like a bug. Beijing has even heeded the MPIA's authority in the case of a losing challenge; by contrast, the U.S.' EV tariffs are appealing to nobody. Third, even if Chinese EV's were to somehow magically surmount the sky-high U.S. tariff wall, they would be blocked out of the U.S. market by the Biden administration's 'foreign entity of concern' rules (in the Inflation Reduction Act and Bipartisan Infrastructure Law) and the draft 'connected vehicles' rule. By contrast, BYD has already established greenfield operations in the EU and Chinese EV companies are in talks with European counterparts regarding setting up distribution networks on the continent. Finally, there is a fair likelihood that the EU and Chinese sides will arrive at a negotiated settlement on the provisional duties, not unlike their price and volume undertaking on solar panel and component imports a decade ago. The two sides have kicked off consultations already. By contrast, there is nothing on EVs to be consulted about insofar as Washington is concerned, and more than three years into her tenure USTR Tai has yet to even show up in Beijing. Blowhard talk by the G7 is just that. Lots of heat; little light. And not a terribly useful guide to action.

[**Expanded Reading**]

- Joe Biden forging ahead with efforts to counter China as Donald Trump, election loom large, *South China Morning Post*, June 24, 2024
- Ukraine war: US warns China to halt exports that support Russia or face 'further steps', *South China Morning Post*, June 19, 2024
- Foreign Ministry Spokesperson Lin Jian's Regular Press Conference on June 17, 2024, Ministry of Foreign Affairs of the People's Republic of China, June 17, 2024
- G7 Apulia Leaders' Communiqué, The White House, June 14, 2024
- G7 threatens China with further sanctions over Russia war support, *Financial Times*, June 14, 2024
- Rich countries unite against China … sort of, *Politico*, June 14, 2024
- G7 vows to counter 'economic and national security threats' posed by China, *South China Morning Post*, June 14, 2024
- On-the-Record Roundtable by APNSA Jake Sullivan Previewing the President's First Day at the G7, The White House, June 13, 2024

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2 — Treasury Releases Proposed Rule on China Outbound Investment — 2

[**In One Sentence**]

- The U.S. Treasury Department released a Proposed Rule to implement President Biden's Executive Order of August 2023 on outbound investment controls.
- The Proposed Rule prohibits U.S. investment in China and Chinese companies that the U.S. government determines as posing "a particularly acute national security threat because of its potential to significantly advance the military, intelligence, surveillance, or cyber-enabled capabilities" of China.
- The Proposed Rule lists a number of industries and technologies that are either barred for U.S. investors or trigger a notification requirement, but does not provide an explicit definition for "national security."
- China expressed "deep concerns" and "firm opposition" to the United States' proposed rules on outbound investment controls, adding that it "reserves the right to take corresponding measures."

[**Mark the Essentials**]

- The release of the Treasury Department's Proposed Rule comes 10 months after President Biden signed Executive Order 14105, which tasked the Treasury to issue specific regulations that ban or require prior notification for certain U.S. investments in China. It constituted the first instance ever of the U.S. government seeking to regulate outbound capital flows for national security reasons.
- Specifically, U.S. citizens, companies and foreign subsidiaries under their control are prohibited from certain investment, acquisition or business expansion in China or related to Chinese companies if they engage in, among others: the development of semiconductor design software; front-end semiconductor fabrication equipment; high-performance, advanced or cutting-edge semiconductor; supercomputer and quantum computer; high-performance artificial intelligence (AI) systems; and AI systems that is designed exclusively for military end use, governance intelligence or mass-surveillance.
- The Proposed Rule has been generally welcomed by the business community given its tailored approach. In a statement, the U.S.-China Business Council (USCBC) noted that it "supports the Biden administration's efforts to protect U.S. national security while also ensuring robust commercial exchange with China for the benefit of American companies, workers and our economy."

[**Keeping an Eye On…**]

- Later this year, the other shoe will drop with regard to investment controls and China. In August 2018, Congress and the Trump administration expanded CFIUS' (Committee on Foreign Investment in the United States) jurisdiction beyond transactions that could result in foreign control of a U.S. business to also sweep non-controlling minority investments within CFIUS' inward investment screening remit. The authority applied to non-controlling investments in U.S. businesses that were developing critical technologies, owned or operated critical infrastructure, or maintained or collected sensitive personal data of U.S. citizens—collectively known as TID (technology, infrastructure, and data) businesses. By denying foreign investors of "countries of special concern" from having access to material nonpublic technical information in the possession of that U.S. business, the aim was to shut down gaps and loopholes that could enable the said foreign investor to exploit a minority investment position in an early-stage technology company to obtain cutting edge IP and trade secrets. Chinese FDI in the United States cratered from that point on, in part due to the chilling effect of the measure. Almost six years later, the Treasury Department has now flipped its focus. On June 21, the department issued a 165-page Proposed Rule to control U.S. outbound investments to China. The Proposed Rule follows an outbound investment-related Executive Order issued by President Biden in August 2023 and an Advanced Notice of Proposed Rulemaking later that month. As per the Proposed Rule, U.S. investors are to be prohibited from engaging in transactions that facilitate the advancement of sensitive technologies or products critical to military, intelligence, surveillance or cyber-enabled capabilities by entities that are either: (a) registered and based in China ("country of concern"), (b) placed on any of the U.S. government's restricted lists (e.g. Entity List, Military End User List, SDN List, etc.), or (c) tied to China, by way of substantial interests in Chinese companies, in other jurisdictions (say, via the variable interest entity structure in the Caymans or routed through Middle Eastern investments). The prohibition extends to investments in existing operations too in China insofar as the investment involves a business expansion or pivot to these proscribed technologies or products. The technologies or products listed (the "covered activities"), which are accompanied by highly technical parameters, belong to the semiconductor and microelectronics, quantum information, and artificial intelligence (AI) sectors. On the other hand, the threshold for being deemed to have engaged in a proscribed "covered activity" in China has been kept at the high end (50% of revenue, capital expenditure, operating expenses, or net revenue must be derived from China), meaning that only a narrow subset of U.S. investments in third country firms that have exposure to the Chinese market will fall within the ambit of the Proposed Rule. And exemptions have been built into the rule too - for full buyouts, for intra-company transactions, for certain Limited Partner investments, and for publicly traded security investments. Given that public market investments represent the majority of U.S. capital flows to China, the impact of this outbound investment rule will, as the Treasury Department has maintained, remain tailored and targeted. For better or worse, the Trump and Biden administration's foreign inbound and U.S. outbound investment controls, respectively, on China are here to stay. Since the two sides were never quite 'coupled' in the advanced node chips, quantum, and AI sectors, it would be improper to characterize the proposed measure as an instance of 'decoupling'. That said, the gap between the two ecosystems in these sensitive technologies and sectors will only get wider with the passage of time. In September 2022, NSA Jake Sullivan had identified "three [foundational] families of technologies" in which the United States would strive to "maintain as large a [technological] lead as possible." Also that month, the administration issued an Executive Order that premised the flow of investments and technology exchanges on their underlying impact on U.S. technology leadership. The Proposed Rule on outbound investment controls, which is expected to be finalized and issued in almost-unaltered form later this year, is a continuation in this vein.

[**Expanded Reading**]

- U.S. May Tighten Quantum Investment Restrictions On China, *The Quantum Inside*, June 26, 2024
- OpenAI Taking Steps to Block China's Access to Its AI Tools, *Microsoft*, June 25, 2024
- McHenry Statement on Treasury's Outbound Investment Proposed Rule, Financial Services Committee, June 21, 2024
- US Moves Closer to Restricting Outbound Investment in China for Chips, AI Tech, *Bloomberg*, June 21, 2024
- US Treasury Department Moves Closer to Implementing Outbound Investment Restrictions Through Latest Proposed Regulations, *The National Law Review*, June 26, 2024
- Treasury Issues Proposed Rule to Implement Executive Order Addressing U.S. Investments in Certain National Security Technologies and Products in Countries of Concern, U.S. Department of the Treasury, June 21, 2024

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[**Legislative Developments**]

- Underlining the changing nature of global markets and the expansion of e-commerce, Sen. Bill Cassidy (R-LA) and Sen. Catherine Cortez Mastro (D-NV) have proposed a bill to "modernize" U.S. customs laws and improve customs procedures, including with regard to data collection.
- A group of 13 Senate Democrats have introduced a bill to reauthorize the Trade Adjustment Assistance program through 2030 to assist U.S. workers who "lose their jobs because of corporate outsourcing and China's cheating" amidst the U.S. trade policy "failure."

[**Hearings and Statements**]

- Senate Finance Committee Chair Ron Wyen (D-OR) tore into BMW for its failure to conduct adequate due diligence while importing at least 8,000 vehicles that allegedly contained components produced by Sichuan Jingweida Technology Group Co, a Chinese supplier that is banned under the Uyghur Forced Labor Prevention Act (UFLPA).
- Two members of the House China Committee, Reps. Darin LaHood (R-IL) and Jake Auchincloss (D-MA) have called for more legislative measures to push back against China's "protectionist policies" while deepening economic engagement with regions like the Indo-Pacific and the Global South by developing trade initiatives with enforcement mechanisms (e.g., CPTPP instead of IPEF).
- During a June 13 hearing of the House Energy and Commerce Committee's environment, manufacturing and critical minerals subcommittee, witnesses and lawmakers argued that the U.S. should build a resilient critical mineral supply chain by establishing a domestic mining industry, facilitating a "friendshored" supply chain with allies like Australia, and reducing China's footprint throughout the supply chain from mining to processing to recycling.

[**Expanded Reading**]

- Sen. Sherrod Brown Introduces Bill to Reauthorize Trade Adjustment Assistance, Alliance for American Manufacturing, June 21, 2024
- Brown introduces legislation to reinstate trade adjustment assistance, Office of Sen. Sherrod Brown (D-OH), June 18, 2024
- Environment, Manufacturing, and Critical Materials Hearing: "Securing America's Critical Materials Supply Chains and Economic Leadership", House Committee on Energy & Commerce, June 13, 2024
- NCBFAA Applauds Senators Cassidy and Cortez Masto for Customs and Trade Facilitation Framework, National Customs Brokers & Forwarders Association of America, June 11, 2024
- Report Launch: Friendshoring the Lithium-Ion Battery Supply Chain, CSIS, June 11, 2024
- ICYMI: Americas Act Represents Transformational Opportunity for Western Hemisphere, counters China, Office of the Senator Bill Cassidy (R-LA), June 10, 2024
- Finance Chair Wyden Questions BMW over its use of Components Made with Forced Labor, United States Senate Committee on Finance, June 10, 2024