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Trivium China

Markets Note

Tactical jabs: January US-China tech and trade war roundup

January 11, 2024 / No. 192

Welcome to another edition of Trivium's US-China tech and trade war roundup. In these monthly reports, we break down key geopolitical developments shaping the economic relationship between Beijing and Washington.

Here's where things stand as of early January.

Our latest US-China tech and trade war roundup offers a good reminder that any movement toward a more stable US-China economic relationship will be two steps forward, one step back – at the best.

While both sides continued to play up the positive momentum out of the Xi-Biden meeting in San Francisco in November – and even followed through on some of the commitments made at that meeting – the vast majority of concrete moves over the past month have involved ongoing tactical jabs via sanctions, export controls, or legislation.

Over the past month, US officials moved to:

- Further restrict Chinese EV imports into the US
- Take steps toward decertifying Hong Kong's defacto diplomatic presence in the US
- Widen Xinjiang-related sanctions
- Potentially expand the scope of chip-related export controls

For their part, Chinese officials have:

- Widened Xinjiang- and Taiwan-related counter-sanctions
- Expanded the scope of rare earth-related export controls
- Bolstered the domestic legal apparatus to implement (counter-) tariffs against trading partners

Ultimately then, while we welcome the increased high-level and working-level dialogue – as well as the genuine efforts by both sides to put a floor under the relationship – the stark reality for companies and investors is that the US-China minefield is growing ever more rigid and technical.

We cover all the key developments from the last month below – and we'll continue to do so going forward.

The mood in DC

The positive

1. On December 14, US Treasury Secretary Janet Yellen delivered a speech at the US-China Business Council's 50th anniversary gala, **announcing that she would make another trip to China in 2024.**

Yellen highlighted the importance of dialogue:

"For economic policymakers...it is...critical to know the counterpart on the other end of the line and be able to make a quick call."

"To enable this, the United States and China will facilitate exchanges between our financial regulators."

Yellen's not the only one pushing for more communication.

A spokesperson for the Chinese embassy in the US said:

"Representatives from the two defense ministries are in contact and coordination on the issue of resuming contact between defense ministers."

Our take: We're encouraged that both sides are pushing for dialogue.

- Progress on major strategic issues may not be feasible, but working-level communication should help buoy the bilateral relationship and reduce risk.^{1 2}

The negative

1. On November 30, the **US Public Company Accounting Oversight Board (PCAOB) announced hefty fines on China-based auditing firms.**

ICYMI: In 2020, the US Congress passed legislation requiring mandatory delisting from US exchanges for firms whose auditors haven't been reviewed by the PCAOB for three consecutive years.

- Beijing previously prevented foreign regulators from reviewing mainland auditors, citing national security concerns.
- After an extended back-and-forth, Chinese officials agreed to let PCAOB inspectors review Chinese companies' audit papers in 2022, heading off mass delisting of Chinese companies in the US.

Since then, however, the PCAOB has uncovered foul play, and it's dished out some penalties.

- PwC Hong Kong and PwC China were fined USD 4 million and USD 3 million, respectively – the second- and third-largest fines the PCAOB has ever imposed – for helping employees cheat during mandatory audit training courses.
- Shandong Haoxin and four of its auditors were fined a total of USD 950,000 for guaranteeing – and then giving – a clean audit to then-Nasdaq-listed Gridsum. (The SEC later charged Gridsum with failure to disclose millions in related-party transactions.)

Our take: There is no risk of the listcos getting delisted.

- The key to avoiding delistings was getting the auditor inspections done.

Our other take: This saga looks to have resulted in the best-case scenario – no mass exodus of Chinese companies *and* heightened oversight of auditor behavior.^{3 4 5}

1 US Treasury: Remarks by Secretary of the Treasury Janet L. Yellen on the U.S.-China Economic Relationship

2 Sputnik: 中国驻美使馆:中国军方愿与美方合作以恢复最高级别接触

3 PCAOB: Imposing \$7.9 Million in Total Fines, PCAOB Sanctions Three China-Based Firms and Four Individuals in Historic Settlements

4 PCAOB: Chair Williams Statement on the PCAOB's Enforcement Orders Against China-Based Firms

5 SEC: Securities and Exchange Commission v. Guosheng Qi and Gridsum Holding, Inc. and Relief Defendant Huijie He

2. On December 1, the US Treasury released guidelines aimed at expanding domestic manufacturing of electric vehicle batteries, as part of provisions related to the Inflation Reduction Act.

The guidelines explain that, **starting in 2024, vehicles containing battery parts made by “foreign entities of concern” (FEOCs) are not eligible for USD 7,500 tax credits.**

- By 2025, vehicles containing critical minerals extracted, processed, or recycled by an FEOC will also be ineligible for tax credits.

Some context: FEOC is a broad term, but in this context, essentially all components and minerals coming from China are covered.

Our take: The reprieve on critical minerals gives carmakers some much needed space to sort out alternatives in a supply chain that is currently dominated by China.

Our other take: Chinese EVs are very rare in the American market – and it is now unlikely that they will ever make inroads.

- Beyond finished EV exports, these measures seek to break China’s growing control over the broader EV supply chain – and could have substantially positive implications for Western industry.

Our other other take: These guidelines, in addition to Europe’s ongoing investigation into Chinese EV subsidies, may ultimately be a major blow to China’s lofty global EV ambitions. ^{6 7}

3. On November 29, the **Hong Kong Economic and Trade Office (HKETO) Certification Act** was approved by the House Foreign Affairs Committee.

- The Senate Committee on Foreign Relations approved its version of the bill in July.

Some context: HKETOs are quasi-embassies/consulates based in Washington DC, New York, and San Francisco (along with dozens of other international locations) and serve to promote trade and cultural exchange between Hong Kong and other countries.

The bill would require the US executive branch to annually determine whether HKETOs operating in the US should continue to be given certain legal immunities and remain exempt from property taxes.

- The key question is whether Hong Kong remains sufficiently autonomous from the mainland to warrant separate international institutions.

Per the bill, if the HKETOs are deemed to “no longer merit” such privileges, they will have to terminate operations within 180 days.

Our take: This bill will likely pass.

- US policy increasingly treats Hong Kong as an extension of the mainland – in conjunction with Beijing’s policies – starting with the revocation of Hong Kong’s special trade status in 2020.

⁶ Reuters: US to limit Chinese firms, battery parts from winning EV tax credits

⁷ U.S. Department of Treasury: Treasury Releases Proposed Guidance to Continue U.S. Manufacturing Boom in Batteries and Clean Vehicles, Strengthen Energy Security

Our other take: While the city remains significantly more open and internationally connected than the mainland, moves like this demonstrate that many foreign governments regard Hong Kong as increasingly less autonomous – and are backing up that view with concrete policy measures.^{8 9 10}

4. On December 8, the **US Treasury's Office of Foreign Assets Control (OFAC) sanctioned two Chinese officials for their role in alleged human rights abuses in Xinjiang.**

The officials are:

- Gao Qi, head of the Public Security Bureau in Yili Kazakh Autonomous Prefecture.
- Hu Lianhe, longtime Deputy Office Director for the Xinjiang Work Coordination Small Group of the Central Committee – an office which has been instrumental in crafting Beijing's Xinjiang policies.

Gao and Hu were sanctioned in conjunction with 18 other individuals from across the world, in commemoration of the 75th anniversary of the Universal Declaration of Human Rights.

Our take: Xinjiang has largely faded away as a topic of discussion in the US-China relationship, but symbolic sanctions like these serve to at least keep the issue – which is a persistent geopolitical thorn in the side for Beijing – on the international radar.^{11 12}

5. On December 13, the **House Foreign Affairs Committee moved closer to sending four new export control bills to the House floor for a vote.**

- Per Bloomberg sources, the new bills would “give the Departments of Defense, State, and Energy equal voting power in an export controls licensing committee that’s chaired by Commerce.”
- They would also push the departments of Commerce, Treasury, and Defense to synchronize their trade restrictions lists.

Some context: House Republicans – notably Foreign Affairs Committee Chairman Michael McCaul – have long criticized the Commerce Dept’s Bureau of Industry and Security (BIS) for not being tough enough on China.

- McCaul believes the BIS is still permitting the outflow of too many technologies.

On December 6, McCaul issued a report arguing that the US and its allies should undercut China’s tech self-reliance ambitions by:

8 SCMP: Mainland China, Hong Kong condemn US committee over bill that could lead to shut-down of city’s representative offices in country

9 Foreign Affairs Committee: HFAC Markup on Various Measures

10 Congress.gov: H.R.1103 - Hong Kong Economic and Trade Office (HKETO) Certification Act

11 SCMP: Xinjiang: US adds more Chinese officials and companies to sanctions list

12 US Department of Treasury: Treasury Designates Perpetrators of Human Rights Abuse and Commemorates the 75th Anniversary of the Universal Declaration of Human Rights

“[F]ully restricting China’s access to semiconductor architecture, electronic design automation software, machine tools, and fabrication facilities.”

Our take: These bills are geared towards realizing a highly restrictive vision for export controls.

- As we stated when a similar bill was tabled in October 2022, implementing that vision would be catastrophic for US-China relations.

Our other take: A major restructure of the US export control regime is overkill.

- BIS is already motivated to come down harder on China – but Commerce is still operating on the same USD 200 million budget it had a decade ago.
- Why not just give BIS more money?^{13 14 15}

The mood in Beijing

The positive

1. On December 7, speaking at an anti-narcotics teleconference, Minister of Public Security Wang Xiaohong said:

“[China must] strengthen oversight of narcotics, deepen control of fentanyl...and deepen international cooperation.”

That is good news: Beijing is following through on what Xi committed to at his meeting with US President Joe Biden in November – combating fentanyl trafficking.

Our take: Fulfilling commitments fosters goodwill.

- While goodwill won’t solve the fundamental issues haunting US-China ties – like US tech exports and China’s support for Russia – it is critical for generating positive momentum for more cooperation down the line.

What to watch: The potential establishment of a counternarcotics working group – another deliverable from the Xi-Biden meeting – would signal whether fentanyl really can become an area of substantive cooperation between the two countries.¹⁶

2. According to the new export control catalogue of the Ministry of Commerce (MofCom) and the Ministry of Science and Technology (MoST), released on December 21, **Beijing has decided not** to restrict solar technology exports.

13 US Foreign Affairs Committee: HFAC Markup on Various Measures

14 US Foreign Affairs Committee: Bureau of Industry and Security: 90-Day Review Report

15 Bloomberg: Republican Slams Lax Enforcement of China Tech Trade Curbs

16 news.cn: 王小洪在全国禁毒工作电视电话会议上强调 坚定不移走中国特色毒品问题治理之路 奋力谱写新时代中国毒品之治新篇章

Some context: In December 2022, policymakers revised the catalogue of technologies subject to export restrictions, pending public feedback.

- The most notable additions were several manufacturing technologies for solar cells.
- China dominates the production of solar panels and wants to protect the technology from being transferred to other countries.

So why did officials backtrack? Industry pushback.

- Most notably, at the Two Sessions in March, Bai Chongen, vice chair of the All-China Federation of Industry and Commerce, argued the restrictions would kill Chinese firms' plan to expand solar capacity in overseas markets – undermining China's dominance in the long term.

Our take: By siding with industry, policymakers are signaling that economics is still an important counterweight to national security.

The big question: Will Beijing adopt a similar mindset in forming its mineral export controls? ^{17 18 19}

The negative

1. On December 26, **China's Ministry of Foreign Affairs (MoFA) announced sanctions on one US company and two human rights researchers for their work related to Xinjiang supply chains.**

The sanction-ees are:

- Due diligence research firm Kharon
- Edmund Xu, Kharon's director of investigations
- Nicole Morgret, a former human rights analyst with the Center for Advanced Defense Studies (C4ADS) who currently works for the US-China Economic and Security Review Commission.

Some context: The sanctioned entity and individuals have all produced work related to forced labor in Xinjiang.

Our take: The sanctions – which will have little practical impact – are almost certainly a response to US sanctions on Chinese officials for their alleged roles in human rights abuses in Xinjiang. ^{20 21}

2. **China wants to protect its dominance in the global rare earth supply chain.**

- That's the cue we picked up from the new export control catalog of the Ministry of Commerce (MofCom) and the Ministry of Science and Technology (MoST), released on December 21.

17 MofCom: 商务部 科技部公告2023年第57号关于公布《中国禁止出口限制出口技术目录》的公告

18 MofCom: 关于《中国禁止出口限制出口技术目录》修订公开征求意见的通知

19 Caixin: 政协委员白重恩: 建议不限制光伏硅片制备技术出口

20 Bloomberg: China Sanctions US Firm, Two Researchers Over Xinjiang Work

21 MoFA: 2023年12月26日外交部发言人毛宁主持例行记者会

What caught our eye: Policymakers banned the export of material processing technologies for making rare-earth permanent magnets.

Why it matters: Permanent magnets are critical components for various industrial markets, including electric vehicles, consumer electronics, and wind turbines.

China has an undisputed dominance in this space: The country refines 89% of the world's rare earths.

- This means even countries with substantial rare earth deposits are heavily dependent on China for processing and manufacturing.

Our take: The new ban won't disrupt the global rare earth supply chain, as it doesn't restrict the exports of end products.

- Rather, the goal is to prevent China's process technologies from falling into the hands of Western countries – which have begun moving to build out their own rare earth supply chains to reduce dependence on China.

The bottom line: Beijing wants to preserve foreign countries' dependence on China in this space for as long as possible.^{22 23}

3. On January 7, **China's Ministry of Foreign Affairs (MoFA) announced sanctions on five US defense companies in connection with arms sales to Taiwan.**

The sanction-ees are:

- BAE Systems Land and Armament
- Alliant Techsystems Operation
- AeroVironment
- ViaSat
- Data Link Solutions

Some context: These sanctions are a response to the State Department's recent approval of up to USD 300 million in military equipment sales to Taiwan.

Our take: Like other sanctions on US military companies, these moves are almost entirely symbolic, as these companies have no significant business operations in China.^{24 25}

4. At the end of December, **China's legislature reviewed a draft of the upcoming Tariff Law and added some language to hit back against foreign economic coercion.**

Some context: The central government is in the process of overhauling its taxation regime, including by shifting taxation power from the State Council to the legislature.

22 MofCom: 商务部 科技部公告2023年第57号关于公布《中国禁止出口限制出口技术目录》的公告

23 Reuters: China's rare earths dominance in focus after it limits germanium and gallium exports | Reuters

24 Bloomberg: China Sanctions Five US Defense Firms on Taiwan Arms Sales

25 MFA China: 外交部发言人就反制美国向中国台湾地区出售武器、制裁中国实体答记者问

- A plethora of State Council taxation regulations have been upgraded into laws, drafted and overseen by the legislature in recent years.
- Usually, the process doesn't substantially change the content of the tax regulations.

But the revised Tariff Law has an interesting change:

- The draft calls for "enhancing tariff response measures," including by developing responses to countries that "fail to comply with the most favored nation treatment or tariff preferential clauses."

Translation: You tariff us, we're going to tariff you back...legally.

Our take: China's recent diplomatic efforts have focused on reducing economic tensions with major trade partners – but policymakers want the option to retaliate systematically if push comes to shove.

Our other take: Building out the legal basis for counter-tariffs raises risks for MNCs whose home countries have trade disputes with China.

- But more legal clarity on the issue will at least give foreign companies a better idea of what to expect.^{26 27}

Stay tuned for next month's update – there's sure to be plenty on the boil.

Why the tech and trade roundup? And why now?

Geopolitics is increasingly at the center of China's economic story. Given the US is actively taking steps to reshape its relationship – and that of its allies – with China, it's become necessary for multinational companies and investors to keep track of the expanding list of China-focused economic restrictions and Beijing's evolving approach to dealing with them.

Thus, we've recently kicked off the Trivium China Tech and Trade War Roundup! Each month, we'll bring you a recap of key developments in China-related cross-border trade and investment restrictions and assess where things are headed.

We hope you enjoy it – and feel free to send through comments and suggestions for improvement any time.

²⁶ NPC: 关税法(草案)征求意见

²⁷ NPC Observer: 关于《中华人民共和国国务院组织法(修订草案)》修改情况的汇报

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