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The G20: What to Watch

26 June 2019

On June 28, 2019, world leaders will convene in Japan for the Group of 20 ("G20") meeting, the annual gathering of select countries representing about 80% of the world's gross domestic product. Though major themes for this year's meeting include promoting trade and investment and harnessing the power of technology, it is actually taking place against the backdrop of an existing trade war between the U.S. and China and an increasing strategic competition between the two over who will exercise leadership in emerging technologies. One front may impact global economic growth in the coming quarters, while the other may set in motion a gradual decoupling whose effects may be felt over the next generation. Even between the U.S. and the European Union ("EU"), questions over alignment with international trade and foreign policy objectives, such as with respect to Iran, threaten to expose fissures between these allies.

The G20 Summit

The G20 is formally known as the Summit on Financial Markets and the World Economy. It was established in 1999 after the Asian financial crisis, and then took on heightened importance after the 2008 global financial crisis. Though initially a forum for finance ministers and central bankers to discuss and coordinate monetary policy, it is now attended by leaders of the EU and 19 additional countries, and serves to promote international economic cooperation more broadly. As a result, the G20's agenda has grown beyond finance into issues including anti-corruption, climate change, counter-terrorism, energy, public health, and trade and development generally.

This Year's Agenda

As it relates to trade, investment and the global economy, the agenda for this year's G20 raises concerns that current developments "*surrounding international trade are negatively affecting the prospects of global economy and trade.*" In this respect, agenda points include a dialogue on macro-level international trade developments, specific discussions on recent developments in bilateral and regional trade agreements, and consideration of global steel excess capacity. The G20 also proposes to take up the nexus between trade and the digital economy, with a focus on emerging technologies such as artificial intelligence, data analytics and robotics.

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At the 2018 G20 in Argentina, there was largely a consensus across countries in support of the Paris climate accord, though it did not include the U.S. Members also affirmed their support for a multilateral approach to international trade under the auspices of a reformed World Trade Organization instead pursuing a more unilateral and bilateral approach.

Special Agenda Items

Here are key points to watch:

1. U.S. tariffs on China

When U.S.-China trade talks concluded in May without a deal, observers speculated that the hoped-for agreement might be forthcoming after the G20. However, with the gathering now just days away, this outcome is in question. It was only recently confirmed that Presidents Trump and Xi would even meet at the G20. Also, President Xi's visit to North Korea just a week earlier may be intended as a reminder that China has some leverage in the trade negotiations, as it has a central role to play with respect to North Korea, an important foreign policy priority of the Trump administration, and/or as a signal to probe whether the U.S. might be willing to reduce some of its trade demands on China concerning forced technology transfer and the safeguarding of intellectual property, if China in turn shows it can help catalyze progress in the U.S. denuclearization negotiations with North Korea.

As a result, now it appears that the most favorable possible outcome of talks between Trump and Xi at the G20 is that enough progress is made to avert the imminent imposition of additional tariffs. The Trump administration has already begun the process of implementing a fourth round of tariffs on all Chinese goods not covered by the first three tranches. Approximately 50% of Chinese imports — worth $250 billion — are already subject to 25% tariffs as of this spring, including those that were recently raised from 10% to 25%. Should the administration choose to proceed with the fourth round, the tariffs could potentially be imposed by the end of the summer or early fall and effectively cover 100% of Chinese products imported into the U.S. Last year's G20 resulted in President Trump postponing a scheduled tariff increase on China, and there is some anticipation that the same could occur again this year.

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2. U.S. measures against Chinese technology

On May 15, 2019, the Trump administration took two major steps to raise the stakes of the U.S.-China strategic competition in leading technologies such as 5G telecommunications. First, the U.S. Commerce Department's Bureau of Industry and Security ("BIS") designated Huawei and 68 of its affiliates on the Entity List, barring them from receiving parts, components, software and technology subject to the Export Administration Regulations without a license, effectively cutting the company off from the U.S. supply chain. According to some reports, this could cost Huawei up to $30 billion in lost revenue. Given the measure's impact, BIS issued a temporary general license until August 19, 2019, permitting certain transactions including those necessary to maintain and support existing fully operational networks and equipment, subject to pre-existing contracts between Huawei and third parties. Whether the listing of Huawei is more than a bargaining chip in the trade deal negotiations remains to be seen.

Second, just hours before the designation of Huawei on the Entity List, President Trump signed an Executive Order on Information and Communications Technology and Services, setting the stage for forthcoming rules that could impose a broader sectoral ban on dealing with Huawei and other Chinese companies. Given the Executive Order's authority to act against what the U.S. may determine poses an unacceptable risk to national security, it could also cover parties from countries such as, for example, Iran, North Korea and Russia. The Executive Order is authorized under the International Emergency Economic Powers Act ("IEEPA"), the same statute that underpins most U.S. economic sanctions and by which the U.S. has asserted far-reaching jurisdiction. For example, foreign subsidiaries of U.S. companies and companies operating in China whose headquarters are outside of China, could potentially be subject to its prohibitions. The Executive Order's implementing rules will not be issued until October 2019, and its impact could likely outlast resolution of the trade war.

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3. Retaliation by China

These actions by the U.S. raise the question of whether China will retaliate and in what manner. One focus area may be rare earths — materials that are an important input in the production of several high-technology products and defense-related products — as well as consumer items such as cell phones. Currently, China has a dominant position as the world's main harvester and supplier of rare earths, while the U.S. does not have sufficient processing capacity of its own. Recently, the Chinese National Development and Reform Commission announced that it might establish a mechanism to restrict exports of strategic resources such as rare earths, a step that was viewed as motivated by rising trade tensions with the U.S. China could potentially leverage such an export controls regime to try to constrain the U.S. supply chain.

Also, the Chinese Ministry of Commerce recently stated it is creating its own "Unreliable Entity List," indicating that the Ministry will make such designations based on whether entities: (i) have adopted discriminatory measures against Chinese entities (e.g., a cut in supply); (ii) violate market rules for non-commercial purposes; (iii) cause actual damage to Chinese companies; and (iv) as a result, pose a threat to China's national security. Immediately thereafter, China's National Development and Reform Commission called meetings with high-profile U.S. and non-U.S. technology companies such as Dell, Microsoft, Nokia, Qualcomm and Samsung. These measures stand to impose collateral impacts on companies from all countries operating in the information and communication technology sector.

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4. EU trade with Iran

On June 10, 2019, the day before meeting with Iran's President Rouhani, German Foreign Minister Maas indicated that a clearing house-type mechanism, designed to support trade with Iran without implicating U.S. sanctions, would be operational soon. The Instrument in Support of Trade Exchanges ("INSTEX"), which was established by France, Germany and the United Kingdom, would provide for a channel of trade with Iran with no nexus with the U.S. financial system. For example, according to reports, through INSTEX, a European trader could import goods from Iran and make payment to a European aircraft parts manufacturer, which in turn could export parts to a buyer in Iran, who then would make payment to the Iranian exporter, completing the transaction.

Nonetheless, the U.S. has indicated it considers INSTEX to be an effort to evade U.S. sanctions and thus vulnerable to "secondary sanctions," if the mechanism is used for purposes other than humanitarian trade, such as for oil transactions. Under such sanctions, even non-U.S. individuals and entities outside U.S. jurisdiction could find themselves cut off from the U.S. financial system and access to U.S. dollars, an important policy lever. For example, when Treasury Secretary Mnuchin indicated the U.S. could impose sanctions on the Belgium-based Society for Worldwide Interbank Financial Telecommunication ("SWIFT") if it were to provide services to certain Iranian financial institutions, SWIFT adhered because it is the funds transfer messaging system relied upon by financial institutions worldwide. A similar fate potentially could befall INSTEX; its Iranian counterpart, the Special Trade and Finance Institute; and any party that trades with Iran through them, particularly as tensions in the Persian Gulf are rising.

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Action Items

- U.S. companies importing from China should prepare for increasing costs and restrictions in the supply chain and potentially diminishing returns in the value chain.
- U.S. and non-U.S. companies operating in China should prepare for additional regulatory headwinds that may further complicate their ability to do business.
- As the U.S. and China potentially prepare for a long-term conflict over technology, companies may have to start choosing either country as their principal supplier and market.
- Parties worldwide are potentially at risk of being denied access to the U.S. financial system if they trade with Iran, given the U.S.' demonstrated willingness to apply sanctions extraterritorially.

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Anais Bourbon was also a contributing author to this publication (*New York admission pending).*

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Suggested Reading

- 27 June 2019 Kirkland Alert Revised Proposals for Marketing of Funds in Europe
- 26 June 2019 Press Release Kirkland Represents Arlington Capital Partners in Final Closing of $1.7 Billion Fund
- 25 June 2019 Press Release Kirkland Represents AbbVie on Acquisition of Allergan for $83 Billion